



International Accounting Standards Committee®

Press Release

For immediate release

30 November 2000

IASC INVITES COMMENTS ON ACCOUNTING BY MINING AND OIL AND GAS COMPANIES

The International Accounting Standards Committee today published an issues paper on financial reporting by enterprises in the extractive industries, that is, mining and oil and gas companies. The paper was developed with the help of a steering committee of experts on the extractive industries.

The aim of the issues paper is to identify the important accounting and disclosure issues relating to exploration and production activities in the extractive industries and to evaluate the merits of alternative ways of resolving those issues. To provide a focus for commentators, the issues paper sets out the tentative views that the IASC steering committee has developed on some of the most significant issues at this early stage of the project.

Among the critical issues are:

- the extent to which the costs of finding, acquiring, and developing reserves should be capitalised;
- the methods of depreciating (amortising) capitalised costs;
- the degree to which quantities and values of reserves, rather than costs, should affect recognition, measurement, and disclosure; and
- the definition and measurement of reserves.

“Today, there is a wide divergence in accounting standards and practices between countries and within individual countries,” said Sir Bryan Carsberg, Secretary-General of IASC. “Even in the few countries in which financial reporting standards have been prescribed for the mining or petroleum industries, alternative treatments have been allowed and are commonly used.”

Although many companies currently disclose estimated quantities of reserves in the ground, and some disclose estimated values as well, nearly all enterprises use historical costs, rather than values, as the basis of their accounting. Two common methods – known as the successful efforts and full cost methods – illustrate the wide variety of accounting practices today.

Under successful efforts accounting – which is used by most large petroleum enterprises and many small ones, and by some mining enterprises – costs that lead directly to finding reserves are capitalised, while costs that do not lead directly to reserves are charged to expense. On the other hand, under full cost accounting, all costs incurred in searching for, acquiring, and developing reserves in a large cost centre such as a country or continent are capitalised as part of the cost of whatever reserves have been found, even though a specific cost was incurred in an effort that was clearly a failure. Full cost accounting is used by many small to mid-size petroleum enterprises, but rarely by mining enterprises. Many mining companies use approaches that are somewhere between the successful efforts and the full cost methods.

There are important accounting differences not only in which costs are capitalised but also how they are depreciated, how impairment of capitalised costs is recognised, and how provisions for future site clean-up costs are made. The extractive industries also have unique accounting issues in such areas as revenue recognition, inventories, and arrangements that allow two or more entities to share the risks of exploring and developing reserves.

Because of widespread interest in the project, IASC has sent the issues paper to the senior financial officials of nearly 300 extractive industries companies worldwide, with a request that they consider the issues and provide IASC with their comments. The comment deadline is 30 June 2001.

The Issues Paper is over 400 pages in length, and IASC has published a separate booklet summarising the issues. The Summary of Issues may be viewed on the IASC web site: <http://www.iasc.org.uk>. Copies of the Issues Paper can be obtained from IASC on request.

ENDS.

Copies of IASC's Issues Paper: *Extractive Industries*, (ISBN 0 905625 88 9), price £30 each (US\$51) and the *Summary of Issues: Extractive Industries* (ISBN 0 905625 93 5), price £12 each (US\$20), may be obtained directly from IASC's Publications Department, 166 Fleet Street, London EC4A 2DY, United Kingdom, Telephone: +44 (020) 7427-5927, Fax: +44

(020) 7353-0562, E-mail: publications@iasc.org.uk Internet Web Site:
<http://www.iasc.org.uk>

Press Enquiries:

Ken Spencer, Chairman of IASC Extractive Industries Steering Committee, Telephone: +61 3 9830-1091, E-mail: kenspencer@ozemail.com.au

Paul Pacter, Former IASC Project Manager, Telephone: +852 2852-5896, E-mail: ppacter@iasc.org.uk

James Saloman, IASC Technical Director, Telephone: +44 (020) 7427-5908, E-mail: jsaloman@iasc.org.uk

Notes for Editors

The Steering Committee's tentative views may be summarised briefly as follows:

1. An International Accounting Standard on financial reporting in the extractive industries is needed.
2. IASC should develop a single International Accounting Standard with common standards for both the mining and petroleum industries but with separate requirements or guidance for mining or petroleum as necessary to address industry-specific issues.
3. The Standard should be restricted to upstream activities (exploration for, and development and production of, reserves).
4. Information about reserve quantities and values, and changes in them, is a key indicator of the performance of an extractive industries enterprise.
5. The primary financial statements of an extractive industries enterprise should be based on historical costs, not on estimated reserve values.
6. Information about reserve quantities and values, and changes in them, should be disclosed as supplemental information.
7. The Steering Committee favours adoption of a method more consistent with the successful efforts concept than with other concepts.
8. All preacquisition prospecting and exploration costs should be charged to expense when incurred.
9. All direct and incidental property acquisition costs should be initially recognised as an asset.
10. All post-acquisition exploration and appraisal costs should be initially recognised as an asset pending the determination of whether commercially recoverable reserves have been found.
11. Some limit should be imposed if post-acquisition exploration and appraisal costs are deferred pending determination of whether commercially recoverable reserves have been found.
12. All development costs should be recognised as an asset.
13. Construction costs that relate to a single cost centre should be capitalised as part of the capitalised costs of that cost centre (normally depreciated on a unit-of-production basis if the life of the assets is coincident with the life of the reserves, or on a straight-line basis if the economic life is less than the life of the reserves). Construction costs that relate to more than one cost centre should be accounted for in the same way as other property, plant, and equipment are treated under IAS 16, Property, Plant and Equipment (normally depreciated on a time basis).
14. Post-production exploration and development costs should be treated in the same way as any other exploration or development costs.
15. Both the benchmark and allowed alternative treatments of borrowing costs contained in IAS 23, Borrowing Costs, should be permitted.
16. Overhead cost should be attributed to the relevant phase of operations (prospecting, acquisition, exploration, evaluation, development, and construction) and further

identified with a specific prospect, property, or area of interest. The overhead cost should be capitalised if, and only if, the direct costs of that phase of operations are capitalised for that specific prospect, property, or area of interest.

17. The Steering Committee does not favour cost reinstatement (reversing a prior period expense recognition in a subsequent period in which information becomes available that commercially recoverable reserves have been discovered).
18. Costs should be accumulated by area of interest or geological units smaller than an area of interest (for example, the field or the mine).
19. Use unit-of-production depreciation for all capitalised preproduction costs with two exceptions:(a) use straight-line depreciation for capitalised construction costs that serve a single mineral cost centre if the economic life of the asset is less than the life of the reserves and (b) follow IAS 16 for capitalised construction costs that serve two or more cost centres (sometimes called service assets).
20. Changes in reserve estimates should be reflected prospectively, that is, included in the determination of net profit or loss in the period of the change and future periods, consistent with the requirements of IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.
21. IAS 37, Provisions, Contingent Liabilities and Contingent Assets, should be applied without modification to the recognition of removal and restoration costs and obligations in the extractive industries.
22. If the amount of a provision is part of the cost of acquiring the asset, it is recognised as such and is included in the depreciable amount of the asset.
23. The cost relating to a provision necessitated by production activities after an asset is installed should be capitalised as an additional cost of acquiring the asset, if the cost provides incremental future economic benefits.
24. If the cost associated with a provision was initially capitalised, changes in the estimated amount of the provision should be recognised in subsequent periods as an adjustment to the carrying amount of the asset.
25. IAS 36, Impairment of Assets, should be applied without modification to account for impairments of assets in the extractive industries.
26. Impairment of capitalised preproduction costs should be assessed based on proved and probable reserves.
27. An impairment test cannot be applied to deferred preproduction costs whose outcome is unknown. The Steering Committee favours some type of limit if preproduction costs are deferred pending determination of whether commercially recoverable reserves are found.
28. The general provisions of IAS 18, Revenue, should apply to enterprises in the extractive industries, and IAS 18 should be amended to eliminate the scope exclusion.
29. Revenue received prior to the production phase should be recognised as revenue or other income, not as a reduction of capitalisable costs.
30. Royalties paid in cash, royalties paid in kind, and severance taxes should all be deducted as an expense and not from revenue.

31. Inventories of minerals should be measured at historical cost, even if those minerals have quoted market prices in active markets with a short time between production and sale and insignificant costs to be incurred beyond the point of production, and the enterprise intends to sell those minerals in that market.
32. All members of the Steering Committee favour disclosure of reserve quantities. The Steering Committee is divided regarding disclosure of reserve values.
33. Disclose proved and probable reserves separately, and within proved disclose proved developed and proved undeveloped reserves separately.

The Issues Paper contains 16 chapters and other sections as follows:

Preface

Invitation to Comment

- | | |
|------------|--|
| Chapter 1 | Scope |
| Chapter 2 | Description of Upstream Activities |
| Chapter 3 | Reserve Estimation and Valuation |
| Chapter 4 | Historical Cost Concepts of Accounting for Preproduction Activities |
| Chapter 5 | Value-Based Concepts of Accounting for Preproduction Activities and Reserves |
| Chapter 6 | Historical Cost Accounting for Preproduction Costs |
| Chapter 7 | Depreciation of Capitalised Costs |
| Chapter 8 | Removal and Restoration |
| Chapter 9 | Impairment of Capitalised Costs Related to Minerals: Implementation of IAS 36 |
| Chapter 10 | Accounting for Revenues |
| Chapter 11 | Recognising and Measuring Inventories |
| Chapter 12 | The Formation of Arrangements to Share Risks and Costs |
| Chapter 13 | Purchases, Sales, and Retirements of Mineral Properties |
| Chapter 14 | Financial Statement Disclosures Unique to the Extractive Industries: Reserve Quantities and Values |
| Chapter 15 | Financial Statement Disclosures Unique to the Extractive Industries: Other Disclosures |
| Chapter 16 | Research on Recognition and Disclosure of Reserves |
- Glossary of Terms
- | | |
|------------|--|
| Appendix A | Summary of National Accounting Standards for the Extractive Industries |
| Appendix B | Definitions of Reserves in the Petroleum and Mining Industries |
| Appendix C | Bibliography and List of Abbreviations |