

**COMMENT FROM SAMREC & SAMVAL (SSC) SSC WORKING GROUP  
ON THE DISCUSSION PAPER  
FOR EXTRACTIVE ACTIVITIES (APRIL 2010)**

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*Contents:*

Formal responses to the questions raised in the draft IASB Extractive Industry Paper.

**Question 1: Scope of Extractive activities**

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 the extractive activities? If so, please explain what other activities should be included within the scope and why.

**Response: (Discussion Paper Reference - Paragraph 1.6)**

The SSC Working Group agreed with the scope of activities – see “Mining Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project” Page 6, para 3:

Although there is not a universally accepted classification of upstream activities in the extractive industries there are eight activities (phases) which are commonly identified/referenced by companies in providing information on their operations to investors, regulators and others:

- prospecting
- acquisition of mineral rights
- exploration
- appraisal or evaluation
- development
- construction
- production
- closure and decommissioning

These activities provide the necessary framework to develop the accounting standards for extractive industry upstream activities. The accounting for the expenditures related to these activities will depend on the nature of the activity for which the costs are incurred.

Further comments:

- It was considered that it is important to take into account anything that falls under government departments that needs a right or license to extract and the conditions that they placed on their use.
- Once a decision has been made with respect to boundaries defining upstream activities, it should be clearly stated.
- The entity reporting should disclose its policy as to what decision has been made with regard to defining “upstream”.

## **Question 2: Approach**

The project team proposes that there should be a single accounting and disclosure model that applies to extractive activities in both the minerals and oil and gas industries.

Do you agree? If not, what requirements should be different for each industry and what is your justification for differentiating between the two industries?

### **Response: (Discussion Paper Reference - Paragraphs 1.10 and 1.11)**

The SSC Working Group was generally in agreement with the Mining Industry SSC Working Group Draft Response. See “Mining Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project” page 7 paragraph 2 under “Approach”.

“The SSC Working Group agrees with the scope of the DP in that it should apply to extractive activities in both the minerals and oil & gas industries. Despite differences between minerals and oil & gas extractive activities, there are sufficient similarities for a single principles-based accounting standard to apply. This is firmly supported by the project team’s analysis of reserve and resource definitions by the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and the Society of Petroleum Engineers Oil and Gas Reserves Committee (SPE OGRC)) which showed substantive equivalence between the two sets of industry definitions. This mapping concept demonstrates the importance of convergence between oil and gas and mining reporting

requirements. Additionally, the main business activities (i.e., exploration, evaluation, development and production) and geological and other risks and uncertainties are very similar. We believe a single standard and disclosure model will benefit a financial statement user's economic decisions involving investing and lending to entities in the extractive industries.

While a single model is appropriate for the issues included in scope of the Discussion Paper, we believe there are industry specific issues in the oil and gas and minerals industries that will need to be considered separately in the proposed accounting and disclosure model. For example, the Mapping of the PRMS and the CRIRSCO Template in Figure 2.1 of paragraph 2.28 of the Discussion Paper depicts contingent resources in the oil and gas industry as being somewhat analogous to mineral resources in the mining industry. Paragraph 2.40 of the Discussion Paper concluded "that mineral resources are essentially the same as marginal contingent resources in the PRMS in that they are contingent on future events or actions before they can be converted into reserves" However, the probability of the conversion of contingent resources to reserves in the oil and gas industry should be contrasted with the probability of the conversion of mineral resources to mineral reserves in the mining industry. Specifically, contingent resources in the oil and gas industry are defined in Appendix B21 as "those quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations, but the applied project(s) are not yet considered mature enough for commercial development due to one or more contingencies." In contrast, the initial conversion of a mineral resource to a mineral reserve in the mining industry requires the completion of a feasibility study wherein modifying factors such as mining methods, metallurgical, economic, legal, environmental, social and governmental factors are considered".

### **Question 3: Definitions of minerals and oil and gas reserves and resources**

The project team proposes the use of 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) in an IFRS for the extractive activities.

Do you agree? If not, how should minerals or oil and gas reserves and resources be defined for an IFRS?

**Response: (Discussion Paper Reference – Paragraphs 2.9, 2.15, 2.16, 2.17, 2.18, 2.19, 2.20, 2.21, 2.22, 2.61 and 2.66)**

The SSC Working Group was in general agreement with the Mining Industry SSC Working Group response See "Mining Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project" pages 8, 9 and 10.

"The SSC Working Group concurs with the project team's recommendation that existing definitions should be applied when determining reserves and resources for minerals. New definitions should not be developed. The SSC Working Group is of the view that existing definitions should be applied to mineral reserves and resources for the purposes of financial accounting and agrees with the IASB position that developing a new set of

definitions specifically for accounting purposes would be confusing to industry practitioners and inconsistent with the widespread application and understanding of existing definitions. Given the international application of accounting standards, it is essential that definitions adopted in any guidance issued by the IASB for the extractive industries are already in widespread use internationally. The use of CRIRSCO definitions should be applied to mineral reserves and resources, and assessed for comparability with the PRMS. The SSC Working Group believe that the definitions contained in the CRIRSCO Template meet the requirements of wide-spread international use (CRIRSCO comprises representatives from Australia, South Africa, Europe, Canada, USA and Chile). The CRIRSCO definitions are intended for public reporting of mineral reserves and resources and are therefore implicitly targeted at investors and are compliant with a use for market related purposes. Given the similarity of purpose between CRIRSCO type reporting and the concepts used in developing accounting practices, very little modification would be required to the existing CRIRSCO system to accommodate specific accounting requirements. CRIRSCO and SPE have already carried out a mapping exercise to compare the definitions contained in the Template and PRMS on behalf of IASB which demonstrated that while the systems are not identical, their widespread acceptance, comprehensive scope and application principles are consistent with the requirements of the IASB for IFRS purposes. Maintaining this alignment between the Template and PRMS would be a future task for CRIRSCO and SPE in support of IFRS.

The SSC Working Group is of the opinion that the current SEC definitions do not meet the needs of the IASB. The definitions and associated guidelines contained in Industry Guide 7 are inconsistent with international practice, and the rules applied by the SEC to determine reserves (resources are not defined) are inconsistent with many business practices. Accordingly, this would not create an acceptable alternative for the IASB to consider.

The SSC Working Group believes that the current United Nations Framework Classification<sup>1</sup> does not meet the needs of the IASB. While the classification encompasses both minerals and oil and gas, it is intended to serve the needs of energy and mineral supply studies, government resources management and policy formulation, business process management and for financial reporting. As such, its remit is too broad for IASB purposes. Further, as noted in the Discussion Paper, the UNFC is not applied generally, particularly in those areas of most relevance to the IASB, namely business process management and financial reporting. It is noted that the UNFC has adopted the CRIRSCO Template as it relates to reserves and resources as used by mining industry.

The use of entity-specific forecast assumptions (Level 3 inputs) is suitable in circumstances where observable and directly relevant market data are not available, provided that the entity's own assumptions are reasonably expected to fall within the range of market participant views. In the SSC Working Group's view, it is logical that reserves and resources will be estimated and approved by a Competent Person based on an entity's view of future economic inputs, as this is how its operations are run. It would be expected that historical performance would influence the selection of such inputs, but not exclusively. For example, with respect to certain properties, long term

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<sup>1</sup> UNFC 2009 is the most recent version of this classification system and has been prepared by an 'Ad Hoc group of Experts' including CRIRSCO and SPE.

contracts may be more relevant. Comprehensive and relevant long-term market data are generally not available to resource and reserve estimators. Sometimes published prices may be limited to the spot price that may not be a guide to future prices for all commodities. The consequence of their use could introduce volatility into reserve estimates and therefore future cash flow assumptions for impairment testing. Many other parameters are also relevant in the determination of ore reserves including: geological data about the extent and grade of mineralization; methods of processing; transport to market; environmental and political issues; exchange rates; costs of production (including external treatment and refining charges) and capital. As such, directly applicable market data are unlikely to be available covering the entire life of the reserve and resource.

The use of management's intentions in the CRIRSCO definition of reserves is appropriate for disclosure purposes. Management's intention to develop or otherwise monetize mineral reserves is considered implicit in a public disclosure of such reserves and, as such, the SSC Working Group endorses the project team's recommendation.

The project team's view is that reserves based on management's intentions should be disclosed separately from other quantities of minerals that are not currently planned to be developed and produced. The SSC Working Group does not agree with the project team's recommendation. As noted above, management's intent to develop or monetize the mineral reserve is the relevant basis for disclosure. However, if the IFRS 5 criteria have been met that require such mineral asset to be categorized as "Held for Sale", the related reserves would be separately disclosed.

Further Comments:

- Difficulty with UNFC is that there are over 70 categories and sub categories compared with the six in the CRIRSCO Template.
- Concern was expressed with the use of the terms "compatible" and "mapped" in relation to the CRIRSCO Template. Would a mapping exercise as recently undertaken by the Russians be considered compatible?
- The issue of monetization is not relevant in this section.

#### **Question 4: Minerals or oil and gas asset – recognition**

The project team proposes that legal rights, such as exploration rights or extraction rights should form the basis of the minerals or oil and gas asset. The asset 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 both be treated as enhancements of the legal rights asset.

Do you agree with this analysis for the recognition of a minerals or oil and gas asset? If not, what assets should be recognised and when should they be initially recognised?

**Response: (Discussion Paper Reference – Paragraphs 3.7, 3.13, 3.14, 3.15, 3.33, 3.34, and 3.35, 4.61)**

The SSC Working Group was in general agreement with the Mining Industry SSC Working Group response See “Mining Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project” pages 10 and 11.

The SSC Working Group agrees with the project team’s view that (a) the legal rights, such as exploration rights or extraction rights, should form the basis of the minerals or oil and gas asset and (b) the asset should be initially recognised when the legal rights are acquired. We agree with paragraph 3.15 of the Discussion Paper which references paragraph 21.a of IAS 38 regarding the probability recognition criterion being satisfied with respect to the legal rights acquired. Any additional rights and approvals as the DP suggests should be viewed as improvements or enhancements of any initial extraction or exploration rights originally capitalized because these additional rights are tied directly to the underlying initial extraction or exploration rights. Additionally, we agree with the project’s team view to utilize the fundamental asset definition and recognition criteria within existing international guidance to determine when there is an asset that can be recognised in the financial statements.

We differ from the project team’s view regarding information obtained from subsequent exploration and evaluation activities and development works undertaken to identify or access the mineral or oil and gas deposit as de facto enhancements of the legal rights asset. This is because the costs of acquiring such information do not necessarily reflect probability expectations of the future economic benefits of the legal right asset. Alternatively, we believe that the costs of such activities would be evaluated separately for asset recognition from the asset represented by the legal rights. We believe that this view is consistent with IAS 16 requirements for componentization and, further, we are aware of examples where the enhancement costs are recovered without the sale of the underlying legal rights asset. Using the Framework’s definition of an asset (as explained by IFRS statements, such as IAS 16, that clarify the definition of an asset) should be the sole basis for determining whether an asset exists and whether an asset should be recognized. This approach would help alleviate any practical application of when to recognize assets when dealing with exploration rights, or legal rights, as an example, which take a variety of forms in countries throughout the world. The underlying asset definition should address the following key questions in whatever unique scenario a company finds itself: (a) does the entity have enforceable rights that enable an entity to access or deny (or limit) the access of others to the economic resource (in other words, the economic resource can be controlled); (b) does the entity expect to realize positive economic value (in other words, future economic benefits are expected); (c) does the potential asset in question currently exist and does the potential asset have a cost or value that can be measured reliably? For illustrative purposes, the SSC Working Group recommends that the following indicators be considered as examples, inter alia, of evidence for asset recognition – declaration of the existence of Inferred Resources with a reasonable level of confidence as to tonnage, grade and mineral content by a Competent Person whose opinion based on preliminary economic assessments is that future economic benefits could be expected (i.e. more likely than not), and/or an indicative offer by a third party to acquire or enter into a farm-in arrangement.

Finally, the SSC Working Group suggests that an opportunity exists for the IASB to provide clarity with regard to classification of legal rights as tangible or intangible assets in its final standard on accounting for extractive industries. A reference is made in the

Discussion Paper to IAS 38 "Intangible Assets" which is relevant to legal rights being recognised as an intangible asset. Accounting guidance in other jurisdictions has provided clarification that certain use rights may have characteristics of assets other than intangible assets. The SSC Working Group recommends that the IASB consider a similar type clarification in its extractive industries standard.

Further comments from the SSC Working Group:

The question should really be split into 4a and 4b.

- 4a. In principle, the SSC Working Group is specifically in agreement with the first two sentences – the legal right is the recognition. The capitalization of all costs of exploration would have to be carried from this point.
- 4b. The philosophy of enhancement (capitalization) of the asset needs further clarification and guidance to cater for the differences between exploration and mining companies.

#### **Question 5: Minerals or oil and gas asset – unit of account selection**

The project team's view is that the geographical boundary of the unit of account would initially be defined according to the exploration rights held. As exploration, evaluation and development activities take place, the unit of account will progressively contract 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. In addition, the project team's view is that the components approach in IAS 16 "Property, plant and equipment" should apply in determining the items that are accounted for as a single asset.

Do you agree with this being the basis for selecting the unit of accounts of a minerals or oil and gas asset?

If not, what should be the unit of account and why?

**Response: (Discussion Paper Reference – Paragraphs 3.48, 3.49, 3.50, 3.51, 3.52, 3.53, 3.54, 3.57)**

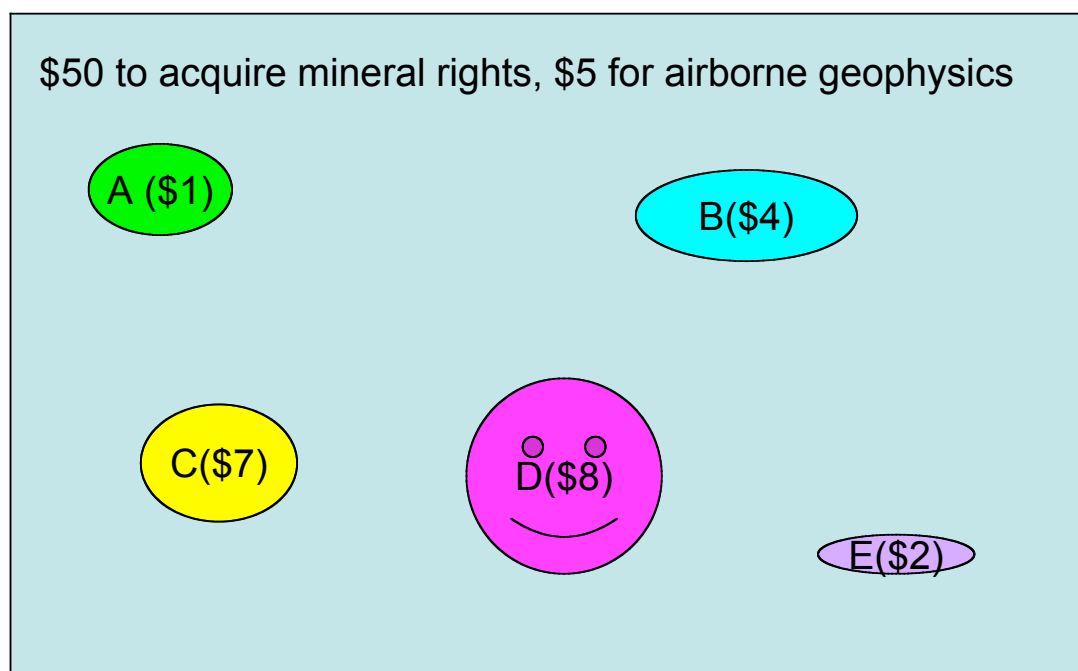
The SSC Working Group was in general agreement with the Mining Industry SSC Working Group response See "Mining Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project" pages 11 12 and 13

We agree with the project team's view that the geographical boundary of the unit of account should initially be defined according to the exploration rights held and, as exploration, evaluation and development activities occur, the unit of account should progressively contract until it becomes no greater than a single area, or group of contiguous areas.

Consistent with the SSC Working Group's recommendation in Question 4, the exploration programme costs incurred to acquire such information would be separately evaluated for asset recognition. However, the SSC Working Group recommends

clarification that any assets recognized as part of the initial exploration activities should be derecognized if their costs were not incurred within the remaining single area or group of contiguous area of interest(s) or did not benefit the entire area of interest, (e.g. aerial surveys), as redefined.

The following diagram illustrates our position:



The entity spends \$50 million to acquire exploration rights to a large block of ground. It performs an airborne geophysical survey over the entire block, and this costs \$5 million. Based on the results of the airborne survey, the company performs follow-up on-site exploration activities at identified areas A, B, C, D, and E costing respectively \$1, \$4, \$7, \$8 and \$2 million. It eventually concludes that only area D should be developed into a mine. Accordingly, the costs of \$1, \$4, \$7 and \$2 million spent at areas A, B, C and E are subject to derecognition. The \$50 million spent to acquire the block and the airborne geophysical survey benefit the entire block and thus are not subject to derecognition.

However, we recognize that several possible scenarios could exist other than the above example and, accordingly, facts and circumstances should be considered in applying the unit of account definition as described above.

For extraction rights we acknowledge that the identification of a single area, or group of contiguous areas, will generally be fairly simple. Extraction rights are generally available to be granted to a holder of an exploration right and thus, after a process of exploration, there will be significant information covering the area identifying mineralization.

For exploration rights, standing alone, the identification of the unit of account according to the exploration rights held may be more complicated than envisioned by the Discussion Paper. The main reason for this is that exploration rights, and contracts that



give rise to exploration rights, are negotiated and issued using various different methods, in various countries and are held by “exploration entities” in a variety of ways. These methods largely depend on

- in which country the exploration property is located;
- if the exploration property is acquired through contract with an existing exploration company; or
- how the contract is structured.

The SSC Working Group recommends that the any guidance issued for extractive activities acknowledge the complexity associated with the identification of the unit of account when exploration rights are involved.

The DP does not address the treatment of general and administration overhead expenditures (e.g. the costs of an exploration office) that are directly related to the exploration activities within the units of account. Most mining companies expense these costs while others allocate such costs to individual projects. Accordingly, cost allocation may result in capitalization of these types of costs if the mining entity has an accounting policy to capitalize exploration expenditures. The SSC Working Group recommends that the IASB consider the accounting for these types of costs in its deliberations.

Further comments from the SSC Working Group:

- Evaluation is a qualitative assessment.
- A valuation is effectively a market transaction between two entities.
- The debate from an accounting perspective is: when you have identified from the valuation which part you are interested in, where does the cost of the part you are not interested in be expended? Shared costs would continue contracting down to the single area. However, there is a school of thought that says that everything adds up to one cost for an area. Cost versus value added - to split the cost between areas will not make costing sense.
- Companies should be given discretionary powers to exercise its judgment

#### **Question 6: Mineral or oil and gas asset measurement model**

In your view what measurement basis should be used for minerals and oil and gas assets 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.

**Response: (Discussion Paper Reference – Paragraphs 4.10, 4.11, 4.24, 4.39, 4.84, and 4.85)**

The SSC Working Group had extended discussion on this question and added several comments to the response given by the Mineral Industry SSC Working Group given below:

“The above question raises the issue of the appropriate measurement basis for mining interest assets. The Draft DP considers three possible measurement bases and raises

significant concerns with each of these. These bases are (1) historical cost, (2) current value, such as fair value, and (3) a mixed historical cost/current value model.

In order to achieve the second and third measurement basis, companies would be required to include extensive disclosures to allow financial statement users to calculate current value.

The IFRS Framework sets out in paragraphs 99 to 101 the measurement of the elements of the financial statements. Currently IFRS allows for a number of differing measurement bases depending on the item being measured including (a) historical cost; (b) current cost; (c) realizable (settlement) value; and (d) present value. Paragraph 101 sites that “the measurement basis most commonly adopted by entities in preparing their financial statements is historical cost.” Historical cost is measured at the amount of cash or cash equivalents paid or the fair value of the consideration given up to acquire the asset at the time of acquisition.

The goal of financial reporting is to provide users with information that: (1) helps users of financial reports to make decisions, (2) can reasonably be viewed as being within the scope of a complete set of financial statements; and (3) meets a cost-benefit test.

In particular, the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. Financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.

The SSC Working Group concurs with the project team’s recommendation that minerals and oil & gas assets should be measured using historical cost, enhanced by disclosure about the entity’s minerals and oil and gas assets. The historical cost of an exploration property or a minerals property includes the cost of acquiring the exploration and extraction rights. The cost also includes the cost of any activities undertaken after the acquisition that enhance the value or the exploration and extraction rights (such as exploration and evaluation activities that generate information about the minerals deposit and development activities that allow access to the deposit). Historical cost accounting produces reliable, verifiable information, with respect to those activities. The historical cost measurement is a methodology that facilitates financial information to be prepared, reviewed / audited and released to the market in a timely manner, using guidance and procedures that are already in place.

The SSC Working Group believes that measurement of minerals and oil & gas assets using a historical cost approach is preferable to measuring these assets using a current value method. The historical cost approach is objective, verifiable, timely and cost effective, although conceding that the approach is based on historical information and therefore not current. However, the SSC Working Group notes that preparers and users of financial information often use different financial modeling assumptions in the determination of fair value. Regulatory and other disclosures, other than those provided in financial statements, provide users of financial information with sufficient detail to model fair value using their own inputs as discussed in more detail in the remainder of this response.

With respect to the project team's recommendation that detailed disclosure about the entity's mineral properties should be provided to enhance the relevance of the financial statements, the SSC Working Group believes that sufficient information already exists and is available in the public domain to enhance the relevance of the financial statements and satisfy the qualitative characteristics of useful financial information. For example, with respect to mineral reserves and resources, users have access to information that is currently publicly available outside the financial statements such as the Reserve and Resources disclosures (CRIRSCO Template compatible reserve and resource statements) and other information included within management commentary and other presentations. This includes industry specific information such as "cash costs", a Non GAAP measure, production statistics and the status of current development projects, including future capital expenditures, that traditionally have been used to provide some type of comparative measure for individual properties and projects. Examples of detailed disclosures about an entity's mineral properties are included in Appendix C for the IASB's consideration. Additionally, an example of production sequencing is provided in Appendix D. The SSC Working Group recommends that these types of disclosures, which are already available to financial statement users, be considered in establishing IFRS disclosure guidance for extractive activities. The SSC Working Group further recommends that such information be referenced in public disclosures to ensure its accessibility to financial statement users.

Furthermore, in certain circumstances, the financial statements themselves provide useful information to users with respect to the qualitative characteristics of financial information. Specifically, the inputs into the valuation model to determine recoverable amounts for the impairment tests pursuant to IAS 36 – Impairment, are already disclosed by entities which have adopted IFRS. IAS 36, paragraph 132, indicates an entity is encouraged to disclose assumptions used to determine recoverable amounts of assets (cash-generating units). Paragraph 134 requires the disclosure of management's assumptions when the cash-generating unit includes goodwill or an intangible asset with an indefinite useful life in its carrying value. The SSC Working Group consider these types of disclosures, when considered in the context of other recommendations in this response and the SSC Working Group's response to Question 9, sufficient to provide appropriate and timely information to users. Irrespective of the fact that the fair value of a property is not recorded in the financial statements, users are advised if the property is impaired and the calculation methodology and management assumptions used in determining this conclusion.

The SSC Working Group believes that its position with respect to recommendations herein is consistent with paragraph 1.12 of the DP which addresses the existing IFRSs that provide guidance for financial reporting issues in the extractive industries, e.g., revenue recognition. Paragraph 1.12 notes that: "Existing IFRSs and standard setting projects address these issues and consequently this paper does not address them." The SSC Working Group believes that the existing information provided by mining companies under GAAP and non-GAAP disclosures and measures, as may be required by regulatory authorities or good practice, is sufficient to meet the disclosure objectives of the DP. The SSC Working Group would be pleased to assist and provide additional information and examples of such disclosures to the IASB for its consideration.

With respect to the discussion in Chapter 4 of the DP on the significant concerns both users and preparers identified about the reliability of current value measures, the SSC

Working Group has the following observations specific to such measurement for mineral assets:

- There is currently no defined and comparable guidance for mining entities to utilize to ensure that the assumptions used in determining fair value would be reasonable, comparable, and reliable. Consequently, such information would not provide the users with relevant data upon which to base decisions.
- Changes in fair value for some mining assets are not realizable economic gains in the short term, as realization usually is dependent on the property achieving commercial production, which could be several years in the future. If changes in fair value for mineral properties were included in net earnings, an entity would most likely include such changes as a Non-GAAP adjustment when reporting “adjusted net earnings” disclosures. Analysts generally do not consider these types of measurements in evaluating an entity’s net earnings.
- Entities engaged in the exploration and development of minerals and properties incur significant expenditures in order to achieve the confidence level of a “Reserve”. The income approach would not be practical as a fair value technique as there are no “Reserves” or mining infrastructure upon which to base cash flows. The market approach may not be available due to limited number of transactions, and the cost approach is not particularly relevant to mineral assets due to the unique characteristics of individual properties. Using a fair value approach for exploration stage companies or for operating companies that are engaged in exploration and development activities may materially misstate the value of the asset.
- There is a lack of verifiable data for the determination of long term assumptions e.g. selling prices, future cost prices, exchange rates, etc. which may drive the majority of the value for a long term extractive industries project (for example 5 years is generally available but 25 years is not). There is also currently no mechanism to establish a single product price for all types of minerals, with some types receiving a premium or discount based on the specific metallurgical physical quality. Furthermore, certain minerals have differences in their accessibility and variability in their metallurgical characteristics, quality and content e.g. high sulphur or low sulphur coal, iron ore, inter alia, which affects the final price.
- This use of standardized assumptions (akin to the requirements in the oil & gas industry under FASB ASC paragraph 932-235-50-30) would require industry participants to fair value their assets using a published list of valuation model inputs. Furthermore, a standardized measure would need to be reconciled to the fair value calculated in the impairment test or the fair value allocated as part of the purchase price of a mining interest in accordance with IFRS 3 in order to avoid confusion. However, in practice, this would likely result in misleading information (i.e. value of the company is not appropriately reflected) as it is not analogous to a fair value methodology. In many cases, exploration potential, which cannot be standardized, provides a significant amount of the value attributable to a mineral asset. For a given reporting period, the development work required to define and delineate an ore body to the confidence level

required to be called a "Reserve" may not be complete. Not including the resource and exploration potential, in many cases, would materially understate the value of the mineral asset. While this approach would reduce the subjectivity concerns of fair value, there are some significant administrative burdens to overcome. How would industry agree on what input assumptions to use? Who or what entity would issue the standardized assumptions? What if there was disagreement on the assumptions? What is the frequency at which the assumptions would need to be revised? What assumptions are to be standardized? Would these assumptions be applied to purchase price allocations? Specifically, verifiable market prices generally exist for Gold, Silver and Copper, but not for Potash, Talc, Diamonds, etc.

- Users of financial information have differing views from preparers of financial information on financial model input assumptions for mineral assets. Accordingly, the subjective assumptions used by preparers for fair value estimates may not provide the users with the most relevant information for their needs. For example, preparers of financial information in the mining industry, have differing forward looking views of the various assumptions required to measure assets on a fair value basis. Valuation model inputs such as commodity price, foreign exchange, development costs and feasibility assessments vary from entity to entity. Furthermore, analysts use different valuation model inputs based on their view of future prices, costs, etc. Users of financial information also have their own views on asset valuation assumptions. They may not necessarily use the information provided by management in their fair value assessment. They would likely take management's information and adjust for their own assumptions in lieu of relying on a fair value measurement provided by the preparer. Often financial analysts focus on income statement information rather than the balance sheet information in relation to assets which are intended to be held with the intent of using these assets over their useful life.

In summary, the above observations regarding the variability, subjectivity and complexity in current value measures for mineral assets leads the SSC Working Group to conclude that such data would not provide current value information that could be relied upon by users.

Further comment and discussion from the SSC Working Group:

- If one has to do fair value on everything at the end of each year this would take up too much time.
- Because commodity prices fluctuate it will be an issue.
- As long as the user has a company's reserves and resources he/she will make his own calculations.
- Fair value would be the thing that everybody would aspire to or want. There has not been much success going down that route. There are subjective judgments being made.

- Historical cost with disclosure? It is possible but difficult.
- The valuation method, if it is just historical cost, will not work.
- As a consequence of transactions during the year, reserves and resources change and so should they be declared as a resource or be disclosed? Accountants say disclose.
- Philosophical problem: 10 years have been spent in creating the SAMREC/SAMVAL Codes. These have been adopted by the JSE. The Codes state that when one prepares documents under Section 12 it is necessary to prepare a CP report which by definition has to contain a valuation which is compliant with the SAMVAL code.
- It was agreed that the fair value approach be given further consideration in future open forums planned by the SSC.

#### **Question 7: Testing exploration assets properties for impairment**

The project team's view is that exploration assets should not be tested for impairment in accordance with IAS 26 "Impairment of Assets". Instead, these assets should be written down to recoverable amounts in those cases where management has enough information to make this determination.

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?

**Response: (Discussion Paper Reference –Paragraphs 4.54, 4.55, 4.56, 4.59, 4.66, 4.67, 4.68, 4.69, 4.70, 4.73, 4.74, 4.75, 4.76)**

The SSC Working Group was in general in agreement with the following from the Mineral Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project" page 24 to 26.

"We agree with the project team's view that the requirements in IAS 36 for disclosure should apply to exploration properties, including those described in paragraphs 130 through 132:

"An entity shall disclose the following for each material impairment loss recognised or reversed during the period for an individual asset, including goodwill, or a cash-generating unit:

- a) the events and circumstances that led to the recognition or reversal of the impairment loss.
- b) the amount of the impairment loss recognised or reversed.

- c) for an individual asset:
  - (i) the nature of the asset; and
  - (ii) if the entity reports segment information in accordance with IFRS 8, the reportable segment to which the asset belongs.
  
- d) for a cash-generating unit:
  - (i) a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reportable segment);
  - (ii) the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with IFRS 8, by reportable segment; and
  - (iii) if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified. [AMD 30]
  
- e) whether the recoverable amount of the asset (cash-generating unit) is its fair value less costs to sell or its value in use.
  
- f) if recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market).
  
- g) if recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.

An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognised during the period for which no information is disclosed in accordance with paragraph 130:

- a) the main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses.
  
- b) the main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.

An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets (cash-generating units) during the period. However, paragraph 134 requires an entity to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when goodwill or an intangible asset with an indefinite useful life is included in the carrying amount of that unit.”

The SSC Working Group concurs with the project team's recommendations for disclosure for

- 1) separate presentation of exploration properties in the financial statements;

2) disclosure of the factors that led to the impairment of exploration properties in the period and the remaining carrying value of those properties; and

3) management's views on why exploration properties that have not been impaired continue to be capitalized.

Additionally, with respect to exploration properties that have not been impaired, the SSC Working Group believes that the IASB should consider expanding these disclosures to include a description of each exploration property that is not being tested for impairment and an update on the current exploration program for the property. At a minimum, with the intent of providing financial statement users with qualitative information to understand management's decision not to test an exploration asset for impairment, management should disclose the following which is consistent with disclosures already adopted by some extractive industry participants:

- a) The location of such capitalized exploration costs by relevant geographic region;
- b) The period over which costs have been capitalized; and
- c) A description of the continuing exploration work program to support continued capitalization.

The SSC Working Group also believes that further clarification is warranted with respect to providing guidance for the level at which the impairment assessment is performed for exploration properties. For example, IFRS 6 permits mining entities to group exploration assets with producing assets for purposes of impairment testing, subject to certain parameters. However, absent specific guidance on this issue, diversity in practice will continue to exist.

#### **Question 8: Disclosure objectives**

The project team proposes that the disclosure objectives for extractive activities are to enable users of financial report to evaluate:

- a. the value attributable to an entity's minerals or oil and gas assets;
- 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? If not, what should be the disclosure objectives for extractive activities and why?

#### **Response: (Discussion Paper Reference – Paragraphs 5.23, 5.26, 5.28, 5.29)**

The SSC Working Group was in general agreement with the Minerals Industry SSC Working Group response given below:

"We generally agree with the project team's view of the fundamental disclosure objectives for extractive activities and believe that investors would benefit from disclosure of the appropriate type and level of information such as:



- the value attributable to an entity's minerals or oil & gas assets;
- the contribution of those assets to current period financial performance; and
- the nature and extent of risks and uncertainties associated with those assets.

We agree with the project team's assessment that disclosure of reserve quantity and value information is critical to understanding the mining entity's financial position and its ability to generate cash flow. With respect to the project team's recommendation for disclosure of Proved and Probable reserve quantities, the SSC Working Group concurs with this proposal. The SSC Working Group also recommends that such disclosures include information with respect to mineral resources. The reserve and resource information should be prepared under a reporting code compatible with the CRIRSCO Template and approved by a Competent Person, as defined. Further discussion of this recommendation is included in the SSC Working Group's response to Question 6. With respect to value attributable to mineral reserves and resources, please see the SSC Working Group's response to Question 9.

We concur that such unaudited information is not required in the notes to the financial statements if it is disclosed elsewhere in information published with the financial statements. Additionally, in lieu of the disclosure elsewhere in information published with the financial statements, we believe that reference could be made as to the location where such information could be accessed.

We concur with the project team's recommendation with respect to the contribution of assets to current period financial performance. The SSC Working Group believes that most mining entities already provide meaningful disclosure about how their minerals assets contribute to measurements of current financial performance under GAAP—for example, through disclosure of segment information (sales revenues and related costs and expenses, including attributable income taxes).

With respect to the nature and extent of risks and uncertainties associated with those assets, the SSC Working Group concurs with the project team's recommendation and believes that this objective can be met with appropriately structured disclosures. Disclosures about business segments provide useful information about the financial results for certain assets. We believe other disclosures about reserves and resources and operating data can be presented in a fashion that allows a user to identify risks and uncertainties associated with those assets. Recommendations for these disclosures are addressed in the SSC Working Group's response to Question 9 of the DP. These include disclosures by commodity, further broken down by country or project (if material), by geographical region and disaggregated where appropriate. Examples of these types of disclosures are provided in Appendix C.

Further comments from the SSC Working Group:

- Page 27: last paragraph: one must disclose the risks. (Mining Industry SSC Working Group Draft Response – IASB Extractive Activities Research Project);
- We need clarification on what is meant by disclosure of “the value attributable” in the first bullet on page 27: This is actually done under question 9 on disclosures that would meet the disclosure objective; and

- Any response must include a reference to inferred resources.

**Question 9: Disclosures that would meet the disclosure objective**

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 recon 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 operating cash flows for the current period and as a time series over a defined period (such as five years).

Would disclosure of these categories of information provide relevant information to users?

Are there any other types of information that should be disclosed?

Are there any reasons why any of these categories of information should not be required to be disclosed as part of a complete set of financial statements?

The Minerals Industry SSC Working Group response is given below:

The SSC Working Group concurs with the project team's recommendations with respect to disclosures for (1) the quantities of Proved and Probable and, separately, the sum of proved and probable reserves, (2) the disclosure of these quantities by geographic location or project, if material, and by commodity (3) and the minerals reserve quantities that it controls, including reserves attributable to interests in joint ventures that are not equity accounted. The SSC Working Group also concurs with the project team's recommendation with respect to separate disclosure for reserves held by equity or cost accounted investees, to the extent that the information is important to users, if available. Further, the SSC Working Group recommends that mineral resource quantities be disclosed for the categories 1 – 3 above, consistent with the project team's views. Further, management should consider relevance to the user when determining the level of aggregation. The SSC Working Group also recommends that the IASB address disclosure requirements with respect to mineral reserve and resource quantities of

mineral assets held for sale. All of the above types of disclosures are already the practice of many entities within the mining industry, either in compliance with regulatory requirements or, as a matter of good practice.

The SSC Working Group believes that the quantities that are disclosed must be approved by a Competent Person in accordance with a reporting code compatible with the CRIRSCO Template. With respect to the project team's recommendation to provide information about the Competent Person who prepared the estimate, the SSC Working Group concurs. However, the SSC Working Group believes it appropriate to include details of where such information about the Competent Person can be obtained in lieu of providing it directly. The SSC Working Group also concurs with the recommendation that if there has been no such valuation, that fact should be disclosed. Further, if the valuation is not current, the date of the most recently completed valuation should be provided.

With respect to the project team's recommendation that royalty and tax payments should be treated as an expense, regardless of whether it is denominated in cash or in kind, the SSC Working Group believes that, given the numerous forms that such arrangements may take, both in fact and law, and the multitude of local, provincial, and federal jurisdictions in which mining entities operate, the facts and circumstances of such arrangements should dictate the reporting of these expenses. For example, a royalty arrangement wherein the payee has ownership in the revenue stream would suggest that disclosure of revenues and reserves on a gross basis would be appropriate.

**(b) Discussion Paper – Paragraphs 5.57, 5.58, 5.63, and 5.64**

The SSC Working Group concurs with the recommendations of the project team with respect to the disclosure of the pricing assumptions and other assumptions used in estimating reserve quantities. Additionally, the SSC Working Group recommends that pricing assumptions used in the estimating of mineral resources be disclosed. The SSC Working Group also concurs with the project team's recommendation that pricing assumptions need not be disclosed if such information is commercially sensitive and such disclosure is "expected to seriously prejudice the position of the entity." With respect to the disclosure of other assumptions to enable users to make investment decisions, such disclosures could include discount rates, foreign exchange rates, metallurgical recovery rates, mining and processing methods, production rates, etc. Significant management judgment would be required to determine which of these assumptions are relevant for disclosure.

The SSC Working Group does not agree with the recommendation of the project team with respect to the presentation of a reserves sensitivity analysis. Variables associated with a sensitivity analysis tend to be correlated e.g. if prices change by 5%, then inflation could change by 1%, foreign exchange could change by 1.5%, input costs could change by 4%. Additionally, these factors can impact cut-off grades and mine design (including mine life and production and processing rates). Accordingly, the SSC Working Group believes that benefits from disclosing such sensitivity analysis is not cost justified. As discussed below, a disclosure that explains the changes in the entity's reserves and resources between the current year and the preceding year should assist users in understanding the nature and extent of estimation uncertainties for mineral reserves and resources.

**(c) Discussion Paper – Paragraph: 5.68**

The SSC Working Group supports the recommendation of providing a reconciliation of changes in the quantities of mineral reserves from year to year either in narrative discussion or in a numerical table format. The SSC Working Group also recommends that a similar type of reconciliation be prepared for mineral resources. If a numerical reconciliation is provided, the format could be similar to that set out in Appendix C.

**(d) Discussion Paper – Paragraph: 5.74**

The SSC Working Group does not support the project team's overall recommendation with respect to provide current value disclosures. The SSC Working Group believes that the disclosures already made by the mining industry and the enhanced recommendations with respect to reserves and resources and the assumptions used in their determination, which are supported by the SSC Working Group in this response, will provide sufficient information for a user to undertake his/her own current value assessment utilizing their determined investment criteria as discussed in the SSC Working Group's response to Question 6.

**(e) Discussion Paper – Paragraph: 5.99**

We agree with the project team's recommendation that disclosure of production revenues need to be presented separately by commodity, with separate presentation of production revenues by geographic region only when the commodity price is subject to local market conditions. Most entities within the extractive industries already provide disclosure of production revenues by commodity type and geographic region as a result of segment reporting requirements in IFRS 8, *Operating Segments*.

**(f) Discussion Paper – Paragraph: 5.101**

We agree with the project team's view that disclosure of the exploration, development and production cash flows in a time series would provide information that can be used by investors to assess an entity's performance. The SSC Working Group recommends that such information be presented on an operating segment basis, consistent with how the chief operating decision maker views the business. We believe that disclosure of this information should be consistent with the period of time for which the related financial statements are presented (*i.e.*, two years for financial statements presented in accordance with IFRS).

Further comments from the SSC Working Group were as follows:

- There is no recommendation to separately disclose success rates.
- Should recommend that there should be a disclosure of exploration results – a qualitative and not a quantitative result.
- It must be approved by a CP in accordance with a reporting code compatible with the CRIRSCO Template.
- Cognizance to be taken of the SAMVAL Code in South Africa.

- The reporting of resources inclusive or exclusive of reserves should be addressed in CRIRSCO rather than with IASB.

## **10. Publish What You Pay Disclosures Proposals**

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 certain categories of payments to governments might be difficult (and costly) for some entities, depending on the type of payment and the specifics of their accounting system.

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-benefits grounds? In your response, please identify and quantify (if possible) the benefits and costs associated with the disclosure of payments to governments on a country-by-country basis.

### **Response (Discussion Paper Reference – Paragraph 6.51)**

The Minerals Industry SSC Working Group response is given below:

We note that many members of the SSC Working Group already subscribe to the Extractive Industries Transparency Initiative (EITI) and have endorsed transparency disclosures, similar to Publish What You Pay (PWYP). Furthermore a number of large mining companies who are not members of the SSC Working Group have also voiced their support for transparency disclosures. We note that there is an increasing trend to greater transparency on the part of industry in all matters of public interest. We also note that PWYP proposals have recently been brought forward in the U.S. Congress, the European Parliament and the United Nations. The SSC Working Group believes that there should be more consultation amongst the interested parties with subsequent participation with standard setters, if required.

In these circumstances some companies have expressed the view that a single standard for PWYP type disclosures would be helpful, in part for the same reasons that a single global accounting standard has validity. The universal application of a single disclosure requirement would avoid duplication of work, confusion arising out of differing standards, and create a level playing field for the extractive industries with respect to disclosure requirements.

The SSC Working Group believes that independent initiatives focused on achieving this type of transparency, such as the EITI, is a proper and adequate forum for these disclosures. Any standards for disclosure should be consistent with sound accounting principles but not set as a standard by the IASB. Consideration could be given to the IASB providing supplementary guidance such as the current exposure draft on Management Commentary.

The SSC Working Group notes that investors who might use PWYP disclosures to assess the ethical merits of an investment currently remain a small proportion of

investors. We do not believe the inclusion of this information as a required disclosure in the footnotes to financial statements would provide further benefit to capital providers beyond what is already disclosed (e.g., in segment data under existing GAAP requirements). Based on our internal discussions with finance and investor relations groups, we believe that the primary focus of capital providers is on the cash that is available to service a company's debt and equity obligations.

We acknowledge that PWYP type information is helpful to capital providers who operate under a mandate that requires certain social investments to make judgments about a company's exposure to country-specific investment risks and reputational risks. However, the current cost benefit analysis would not support its disclosure within the financial statements, and thus PWYP information would be better suited for disclosure in a separate document. For example, in jurisdictions with robust regulatory oversight in place, such information is already available.

Further analysis of the associated costs in the light of aims of the proposal indicates that the most substantial compliance costs may be in areas which are not central to the PWYP proposals but are required in any EITI compliant document under current EITI guidelines. For example, data on sales and embedded taxes would be expensive to collect and disclose but are not key components of the PWYP proposals. Therefore in arriving at the cost/benefit compromise it is important to limit the information captured to the key items; revenue, income and capital based taxes, royalties and other payments. This would eliminate other taxes, fees and payments which are not specific to the extractive industries, are not central to the aims of the PWYP proposals and would prove the most costly data to collect, summarize and audit. Review and audit costs may also be substantial in this context, particularly at the subsidiary level due to lower materiality thresholds.

The SSC Working Group believes that any PWYP type disclosure guidelines that are adopted only apply to the ultimate parent.

Members of the group also noted their experience that tax disclosures are among the disclosures least well understood by the investment community. Detailed information on payments to governments may also easily be misunderstood, or not understood in their proper context, by some financial statement readers, especially given the political context of these disclosures. For example, we note that income tax payments in any one year may not reflect the overall effective tax rate in a jurisdiction due to the timing of payments. This may be due to tax allowances for capital recovery, the tax instalment regime of the host country and other items. We also note that in many instances mining companies make social payments towards community projects for local populations and other groups in communities affected by mining. While these payments are not made to governments they are often prescribed by law.

A number of members of the SSC Working Group noted that care must be taken to clearly define which forms of governments and their agencies would be considered in the scope of any guidance. Concerns in this regard encompass, for example, the legitimacy of polities, and the inclusion of nationalized enterprises. We note that some groups have claims to government status that are not universally acknowledged. In addition, payments to government owned entities may include components that could be considered to have a royalty element, and the consensus amongst the SSC Working

Group was that government owned entities should be within scope. Clarity on these matters was deemed essential to the standard.

Further comments from the SSC Working Group were as follows:

This question is not within the domain of the SSC Working Group and therefore the SSC Working Group declines to comment.