A Report on the International Accounting Standards Board's Extractive Industries Accounting Project

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In December 2000 the International Accounting Standards Committee (IASC) distributed an "issues paper" as part of its extractive industries project. This paper, prepared by a project steering committee, presents the basic accounting and financial reporting issues for the mining and the upstream petroleum industries, as well as the committee's "tentative views" on some of those issues. This 431-page document is accompanied by a 44-page summary of issues which asks the public to express their views on the issues. The deadline for public responses is June 30, 2001, after which time the International Accounting Standards Board (IASB), successor to the IASC, presumably will proceed ultimately to issue an international accounting standard (or standards) on the topic.

This article presents a few of the most important matters under consideration, along with the tentative views of the Steering Committee if a tentative view has been arrived at. However, because the IASB was created in its present form on April 1, 2001, as a successor to the IASC, after the issues paper was distributed, the structure and operations of both organizations are discussed briefly as an aid to understanding the extractive industries project.

Background on the Development of Accounting Standards by the International Accounting Standards Board

Objectives, Structure, and Operations of the Predecessor Organization, the IASC

The International Accounting Standards Committee has described itself as "an independent, private sector body, formed in 1973 with the objective of harmonizing the accounting principles which are used by businesses and other organizations for financial reporting around the world." This is also the purpose of the International Accounting Standards Board.

Makeup of the IASC

The membership of the IASC comprised over 150 professional bodies, referred to as "member organizations," in 112 countries. In addition to the 150 official members, many other professional organizations that were not member organizations also took an active role in the IASC. A key player in the IASC's operations was the International Organization of Securities Commissions (IOSCO), whose membership includes the United States Securities and Exchange Commission (SEC). IOSCO worked closely with the IASC, performing something of an oversight role. IOSCO's primary interest in the IASC was with the quality and strength of the "standards" developed by the latter organization. In 1995 IOSCO and IASC reached an agreement that IASC would revise its existing pronouncements and develop a "core" set of standards of high quality, transparency, and comparability that would provide for full disclosure. In 1998 the IASC announced that it had completed the core standards project. IOSCO agreed that the organization would consider endorsing IASC standards for cross-border capital raising and listing purposes in all global markets once the core standards had been completed and reviewed by IOSCO. In 2000, IOSCO recommended that its members allow multinational issuers to use 30 IASC standards in cross-border listings.

The Level of International Acceptance of IASC Standards

Support for IASC standards has increased largely because of the need for reliable accounting standards for strategic business and financial considerations such as marketability of securities, cross-border mergers and acquisitions, shareholder dialogue, and finance raising. Many countries already endorse IASC standards and have accepted the standards as their own. A notable exception is the US, although the SEC has indicated that when it is convinced that IASC standards are of the same quality as US standards, the SEC will consider recognizing the IASC standards. The SEC does currently allow foreign companies to submit financial statements prepared under IASC standards if the statements are accompanied by a reconciliation to US standards. Still other countries have adopted IASC standards with minor modifications.

In 2000, the European Commission (EC) recommended that the European Union (EU) adopt IASC standards. In February 2001, the EC presented a proposal (to be effective beginning in 2005) for a regulation that would require all EU companies listed on a regulated market to prepare consolidated statements in accordance with the IASC's international accounting standards. Obviously this action would give a tremendous boost to acceptance of the IASC's standards around the world. The G7 finance ministers and central bank governors have also committed themselves to attempt to assure that institutions in their countries will comply with internationally agreed principles, standards, and codes of best practice.

Although the Financial Accounting Standards Board (FASB) has in the past shown reluctance to rely on IASC standards, it has said that if such standards are equal to or better than US standards, they should be allowed. The SEC has taken the same stance. It appears that both groups, especially the SEC, are now contemplating ultimate acceptance of standards of some international group, presumably the IASB. (For an interesting discussion of the future acceptance by the SEC and FASB of international accounting standards issued by the IASC and IASB, see "International Accounting Standard Setting: An Emerging Partnership" by Carrie Bloomer, FASB Project Manager, in the Financial Accounting Standards Board's Financial Accounting Series No. 215-B, December 29, 2000).

On February 1, 2001, at the end of its last meeting, another influential group of accounting standards setters, the G4+1 Group agreed that given the imminent commencement of activities by the new International Accounting Standards Board, the Group would disband and cancel its planned future activities. The G4+1 Group consists of representatives of the national accounting standard-setting bodies of Australia, Canada, New Zealand, and the US. Delegates from the IASC attended as observers. The Group met periodically to discuss difficult accounting and financial reporting problems.

How Standards Were Developed by the IASC

Here is an overview of the procedure that was used by the IASC in developing and issuing an international accounting standard. However, the procedure followed in preparing international accounting standards was not rigidly fixed.

- The IASC would decide to add to its agenda an item that had been recommended by member organizations or others as possibly warranting issuance of a standard.
- The IASC would appoint a "Steering Committee", whose first task would be to decide whether the proposed topic was worthy of having a standard issued.

- The Steering Committee or staff would prepare a "point outline" which would define the scope of the project. The IASC would approve, usually, the point outline.
- The Steering Committee would prepare an issues paper which would explain the nature of the accounting problems involved in the topic for which the issues paper was being prepared and would present alternative solutions to those problems. The issues paper would, in some cases, present "tentative views" which indicated the Steering Committee members' tentative answers to some or all of the questions raised in the issues paper. (In many of the issues papers, no tentative views were presented.)
- In the development of earlier international accounting standards, after responses to the issues raised in the issues paper were received from the public, the Steering Committee would sometimes prepare a draft statement of principles, which would be issued for public comment.
- A final statement of principles might be prepared by the Steering Committee and approved by the board by a simple majority.
- The Steering Committee would then prepare an exposure draft of a standard which, if approved by a two-thirds vote of the IASC, would be issued for public comment. (The exposure draft stage was eliminated in developing some standards.)
- On final approval by a three-fourths vote of the IASC, the standard would be issued.

Some Other Significant Facts Related to the IASC

The total annual budget of the IASC was about £2 million (or about $3 million). Under the old IASC procedure, the trustees selected the IASC members who were part-time employees and could not themselves possibly carry out all of the standards-setting work. As a result, much of the standard-setting work was performed by the Steering Committee appointed for each project. Some critics of the IASC have suggested that on a few projects committee members were chosen in order to make sure that many countries could be represented on the committees and that sometimes those members were nominated without adequate consideration being given to their expertise. It should be noted that members of the Extractive Industries Steering Committee were competent and well-qualified.

The professional staff of the old organization was very small, with only a few permanent professional staff members. The organization was fortunate to have employed on a short-term basis (often two years) a number of excellent staff members from accounting firms, other business organizations, and the academic world. The shortage of permanent personnel made it more difficult to develop top-quality standards in a short period.

The New International Accounting Standards Board

Structure and Makeup of the IASB

The structure of the current organization differs drastically from that of its predecessor. The parent organization for the International Accounting Standards Board is the "IASC Foundation" based in London, but chartered in the State of Delaware. Effective April 1, 2001, the International Accounting Standards Board (IASB) assumed accounting standard-setting responsibilities from its predecessor, the International Accounting Standards Committee. The IASC Foundation is an independent organization, having two main working bodies—the Trustees and the the IASB. There are two other bodies appointed by the Trustees—the Standards Advisory Council (which will give advice to the IASB on accounting and reporting issues) and the Standing Interpretations Committee (which will issue interpretations of outstanding standards). There are no member organizations in the foundation. The IASC Foundation Trustees appoint the IASB members, exercise oversight, and raise the funds needed; the IASB has sole responsibility for setting accounting standards. It seems apparent that Steering Committees, if they will be created at all for new projects, will play a far less important role in the developing of standards than their role under the old organization.

The IASB has fourteen members, twelve of whom are full-time employees and two of whom are part-time employees. The budget for the current organization will be several times as large as the budget for the predecessor organization. Information about the standards and other documents issued by the IASC and about the IASB's structure and activities can be found on the IASC website: IASC.org.uk

Role Played by the United States in the New Organization

Clearly, because of the importance of the US in the financial world, involvement and support of US regulatory bodies and accounting rule-making groups is essential. The structure of the new IASB reflects this. Consider the following:

- Chairman of the Trustees for the new IASB structure is Paul A. Volker, former US Federal Reserve Board Chairman.
- The nominating committee for the first group of trustees was chaired by Arthur Levitt, U.S. SEC Chairman.
- The fourteen IASC Board members include three Americans and at least two other members with close ties to the United States:
  - ♦ Mary Barth (a part-time member), professor at Stanford University;
  - ♦ Anthony Cope, former member of the U.S. Financial Accounting Standards Board;
  - ♦ Robert Herz, a part-time member of the board and a partner in PricewaterhouseCoopers in charge of professional matters in the United States and the Americas;
  - ♦ James Leisenring, previously vice-chairman of the US FASB (Leisenring will be "Liaison to the U.S. Standard Setter"); and
  - ♦ Thomas Jones, vice-chairman of the IASB and a British citizen who has spent much of his professional career in the US and was formerly the principal financial officer of Citicorp.
- The 19 trustees include, in addition to Mr. Volker, the following Americans or individuals with close ties to the United States:
  - ♦ John Biggs, former chairman of TIAA-CREF;
  - ♦ Philip Laskawy, former chairman of Ernst & Young International;
  - ♦ David Ruder, previously professor of law, Northwestern University Law School and former chairman of the SEC; and
  - ♦ William Steere, Jr., previously chairman and CEO of Pfizer, Inc.

In developing new standards there will be much closer cooperation with the standards-setters in countries with well-established accounting standards-setting organizations. These include Canada, France, Australia and New Zealand, Germany, the United States, Japan, and the United Kingdom. In the case of new standards, efforts will be made to coordinate the international standards with standards-setting bodies in the countries listed above and with those in other countries where possible. The procedures for standards-setting have not yet been worked out, but clearly they are coming soon. (It should be noted that the move toward close cooperation between the IASB and national accounting standards-setting groups began under the old structure. For example, in December 2000 the IASC issued a "Draft Standard and Basis for Conclusions: Financial Instruments and Similar Items," a product of an effort by the "Joint Working Group". The JWG was composed of members or representatives of accounting standards-setters or professional organizations in Australia, Canada, France, Germany, Japan, New Zealand, the Nordic countries, the United Kingdom, the United States, and the IASC. (Although not a binding document, it represents a giant step toward ultimate development of international accounting standards that have authority.)

One unanswered question is whether the extractive industries project will be completed under the same procedures as those used in the past (in which case the Steering Committee will play a major role so that the announced timetable of having a standard issued in late 2002 may be achievable) or the IASB will assume direct responsibility for developing the standard. In the latter case, the magnitude of tasks facing the new board would appear to work against having the standard(s) issued on schedule. Apparently there has been no firm decision made by the board on this question.

The Extractive Industries Project

The International Accounting Standards Board's extractive industries accounting and reporting project got under way when the IASC formally added the project to its agenda in April 1998. The staff of the IASC actually began work on the project in March 1999, with some hope to finish in 1999 the issues paper which lays out the accounting issues involved in the project and expresses the tentative views of the Steering Committee. (The IASC staff member in charge of the project has been Paul Pacter, who was a staff member at the FASB and worked on the FASB's project on oil and gas accounting and reporting, which culminated in FASB Statement 19.) Most Steering Committee appointments had been made in late 1998 and early 1999, although two members were added in late 1999.

The issues paper, the summary of issues, and the invitation to comment were published in December 2000 and actually distributed in early January of 2001. The issues paper and the summary of issues are available on the IASC website: iasc.org.uk. Public comments will be accepted until June 30, 2001.

Major Issues Addressed in the Issues Paper, Tentative Committee Views

Although dozens of questions are raised on which public comment is invited, the critical questions, along with the "tentative views" of the Steering Committee may be summarized briefly.

1. Which industries are included in and which are excluded from the phrase "extractive industries"?
   Tentative view: The upstream oil and gas industry and the upstream mining industries are included. Mining is generally limited to the extraction of minerals at or below (perhaps several thousand feet) the earth's surface. All other industries are excluded.

2. Should a single standard be developed for both types of industries, or should two or more standards be developed?
   Tentative view: A single standard is adequate. Many of the underlying issues are common to both the petroleum industry and mining industry. There are, however, some differences that might lead to different accounting conclusions. Therefore, separate sections of the standard may be necessary to accommodate different accounting treatments for the two different industries.

3. Should the primary financial statements for extractive industries be based on historical cost accounting or on some type of value-based accounting?
   Tentative view: Historical cost accounting should be used.

4. If historical cost accounting is used, should the accounting method be what is broadly defined as the successful efforts method, the full cost method, area-of-interest accounting, or some other "hybrid" concept?
   Tentative view: The committee favors a method that is more consistent with the successful efforts concept than with other concepts. (Note: There was no support among committee members for allowing alternative methods, such as "full-costing" and "area-of-interest" costing.)

5. Which preproducton costs should be capitalized and which should be expensed?

   Tentative view:
   - All prospecting and exploration costs incurred prior to mineral rights acquisition should be charged to expense when incurred.
   - All property acquisition costs should initially be treated as assets.
   - All post-acquisition exploration costs should be initially recognized as assets.
   - All development costs should be treated as assets.
   - Some time limit should be imposed if post-acquisition and appraisal costs are deferred pending determination of whether commercially recoverable reserves have been found. After that limit, the accumulated costs would have to be charged to expense.

6. Should costs that have been charged to expense be reinstated if subsequently it is found that commercially recoverable reserves do exist in the relevant area?

   Tentative view: No reinstatement of such costs should be made. (This does not agree with certain IASC standards that provide for reinstatement of costs previously charged to expense. Nor does it agree with the tentative view on impairment recovery on costs related to commercial reserves. It should be noted that the IASC has been criticized because several of its standards have permitted the reinstatement of costs after they have been charged to expense.)

7. If historical cost accounting is used, should there be supplementary notes providing information about estimated reserve quantities (and changes in them) and about estimated reserve values (and changes in them)?

   Tentative view: Because of the importance of estimated reserve quantities, they should be disclosed. The Summary of Issues document states (Tentative View 6) that there is also a tentative leaning to disclose reserve values. There is some question whether the committee actually reached the firm tentative view that reserve values should be disclosed and, in Tentative View 12, it is pointed out that the committee is divided on the issue of value disclosures.

8. What method of depreciating costs related to mineral assets should be followed?
Tentative view: In general the unit-of-production method should be used *unless* the asset's life is less than or greater than the life of the related reserves, in which case the straight-line method should be used. Also assets serving more than one cost center might be depreciated on the straight-line method.

9. Should financing costs related to funds borrowed in connection with a petroleum or mining project be capitalized during the construction period?
Tentative view: Such borrowing costs may be capitalized (the IASC's "benchmark" treatment) or such costs may be charged to expense when incurred. This tentative view agrees with IASC Standard 23, Borrowing Costs.

10. Should future dismantlement, removal, and restoration costs resulting from installation of a facility such as a platform be capitalized and recorded as a liability at the time the facility is installed?
Tentative view: Yes, the discounted value of such future costs should be recorded as an asset and liability, in accord with IASC Standard 37. Subsequent changes in the estimated DR&A costs would be treated as an adjustment of the asset account.

11. Should impairment provisions of IASC Standard 36 (very similar to the FASB statement on impairment) apply to extractive industry assets?
Tentative view: Yes, the treatment of such costs should be in accord with IASC Standard 36.

12. Should an impairment test be applied to deferred exploration costs whose outcome is unknown?
Tentative view: No, it is not practical to assess impairment of such costs. Therefore there should be a time limit on the period during which such costs can be deferred. No tentative view was arrived at that would require or permit the amortization of such costs on the basis of experience.

13. How should royalties and reserves related to the royalties be treated by the working interest owner?
    Tentative view: Any new standard should be consistent with IASC Standard 18. As a result, royalties paid in cash and royalties paid in kind should be deducted as an expense by the working interest owners. Gross production proceeds would be reported as revenue. Correspondingly, the reserves related to future production of such royalties should be included in the reserves of the working interest owners.

14. Which reserves (proved developed? proved? probable?) are to be considered in computing DD&A, in estimating impairment, in making disclosures, etc.?
    Tentative view: No tentative view was expressed on this question.

15. **Other pertinent tentative views**:
    - The cost center for accumulating costs should be an area of interest or a smaller unit.
    - Changes in reserve estimates should be considered prospectively for accounting purposes—that is, they affect the period of change and future periods.
    - Impairment of values of properties containing proved and probable reserves should be measured on the basis of the value of those reserves. (Presumably if this were done, the reserve disclosures should reflect both proved and probable reserves.)
    - Inventories of minerals should be measured at historical cost, even if the minerals have a measurable value and are expected to be sold at that value. (For example, oil in lease storage tanks would *not* be shown at posted field price.) Similarly, revenue would not be recognized at the time of production of precious metals.
    - If proved and probable reserve quantities are both disclosed, they should be disclosed and reconciled separately.

Where Does the Project Go from Here?

As pointed out earlier in this report, the procedure for developing an IASC standard left the project largely in the hands of the Steering Committee. It also was observed that this critical phase of developing a draft of the standard in this project is coming in the middle of a major changeover in the

IASC organizational structure and uncertainty about the role played by various parts of the organization. It appears that in the new structure a Steering Committee will serve primarily in an advisory capacity and that the new IAS board will take a strong hand in developing individual standards. As previously pointed out, the question unanswered is whether the project will continue under the old procedure (and be completed fairly soon—in late 2002) or will be issued under the new procedure. Because the board will have many more pressing problems to worry about, if the new process is used it is likely that the project will be held up.

The IASC web site contains the following schedule for completion of the project:

- Deadline for responses to issues paper–June 30, 2001
- Draft statement of principles–2nd quarter 2001
- Exposure draft of standard(s)–1st quarter 2002
- Final standard(s)–4th quarter 2002