IASB'S RECENT UPDATE ON THE EXTRACTIVE ACTIVITIES PROJECT: A COMMENT

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Abstract

In January 2022, the IASB published an article on the Extractive Activities project where Tadeu Cendon explains the IASB's decision on the project. Although the IASB acknowledges the existence of the problem of diversity in accounting practices in the EI, they have decided to tentatively remove the temporary status of IFRS 6 and also limit the scope of the extractive project to exclude some aspects stakeholders find important. This comment is a reaction to the Board's decision and personal reflections of the author. We find that the IASB's decision may not be based on available empirical evidence but other unexplained factors. Based on existing literature we are tempted to believe; the Board might be subject to significant political pressure which is influencing their decision, or they have decided to choose an easier route to avoid fierce opposition or lobbying that is likely to come from powerful players in the industry. We recommend the Board rescinds its decision and address the issue of diversity of accounting practices in the EI in a more holistic fashion.

1.0 Background to Financial Reporting Challenges in the Extractive Industries

Despite the importance of the extractive industries (EI) to the global economy, financial reporting of their activities have been an issue of deep controversy for several years (Field, 1969; Van Riper, 1994; Gray, Hellman and Ivanova, 2019). This has led to the expression of worry by many and necessitated numerous calls for standardisation of practices in the industry. Contentious among the financial reporting issues revolves around how exploration and evaluation (E&E) expenditures should be accounted for. Owing to the widespread absence of regulation for the industry, several accounting policies have emerged which companies adopt in accounting for these expenditures. Notable among them are the Successful Efforts (SE), Full Cost (FC), Area of Interest (AOI) and Expense All (EA) (Alfredson *et al.,* 2009; Abdo, 2016; 2018). Users of each method have strong arguments in support of their method and against other methods (see Brock, 1956; Field, 1969; Myers, 1974; Baker, 1976) such that any attempt to eliminate any of the methods not be an easy task to achieve.

It may come as a surprise to many that it has been 117 years since Curle (1905) in a quote expressed worry about the extent of diversity of accounting practices in the EI. In his much-cited quote, he notes "*I hope that the time is approaching when the system of standardisation will be extended to mining costs and mining accounts. At the present the methods for each of these are legion and seem designed to conceal rather than reveal the financial position; but there must be* ***some one method****, in accounts especially, which is best of all*" (Curle, 1905, p. 29 cited IN Luther, 1996, p. 67).

Five decades after Curle's expression of worry, Smith and Brock also made similar comment that accounting for mining presents such severe problems that the accounts are "*regarded rather lightly inside and outside the industry*" (Smith and Brock, 1959; p. 14 cited IN Luther, 1996, p. 68).

In a similar fashion, Lourens and Henderson (1972) remarking on the Australian Poseidon boom in 1969 where investors made huge losses opine: "*That some investors made a wrong decision is now clear; what is not clear, although frequently assumed in retrospect is that the published financial reports in some way contributed to such losses. If so, it was argued the time had come to make a stand on the* ***issue of uniform accounting*** *principles for the extractive industries*" (Lourens and Henderson, 1972, p. 4).

In a more recent time, the International Accounting Standard Committee (IASC), the predecessor of International Accounting Standard Board (IASB), reiterated the problem and the need for unifying accounting practices in the EI by underscoring that:

There is currently great diversity in accounting and disclosure practices by the extractive industries enterprises. Also, in many countries extractive industries accounting practices differ significantly from accounting practices used by enterprises in the other industries. These factors make it ***difficult for users to compare*** *financial statements issued by mining and petroleum enterprises in different countries or by such enterprises and other enterprises in the same country* (IASC, 2000, p. 4).

As evident from the quotes, the diversity of accounting practices, among other things, can reduce the value users place on the financial reports and also impedes comparability. Is that what we want for such as important industry which forms a significant proportion of the global stock market (see Stadler and Nobes, 2020), generate huge revenues (see PwC, 2019; Turak, 2020) and attracts massive investment around the world (see World Bank, 2016; International Energy Agency, 2018)?

The questions that beg for answers are as follow: why does the issue of diversity of accounting policies in EI seem to be a concern to many such that several calls for standardisation have been made, yet not much has been done in resolving it? Is the issue not worrying in enough? Are there "invisible hands" militating against efforts to resolve it? Is the IASB not ready to pay the price to resolve this issue? Is the IASB settling for the easy way out?

The purpose of this comment is to critically review the decision of the IASB on the extractive activities project in light of the existing literature to highlight the contradictions and inconsistencies in it and offer recommendations on how the issue can be addressed.

The remaining sections of this article are structured as follows: Section 2 summarises the recent decision of the IASB, section 3 critically analyses the update brief and highlights areas of contradiction and weaknesses in the decision. Section 4 provides the conclusion and recommendations.

2.0 IASB's recent decision brief

At its September 2021 meeting the IASB decided tentatively to explore developing requirements or guidance to improve the disclosure objectives and requirements in IFRS 6 Exploration for and Evaluation of Mineral Resources and removing the temporary status of IFRS 6. However, in their recent update, the IASB argues that it "… lacked sufficient evidence to suggest that the benefits of reduced diversity in the accounting policies applied to exploration and evaluation expenditure would outweigh the costs of implementing any changes. The IASB also considered but decided not to explore developing requirements or guidance for reserve and resource information in financial statements" (Tadeu, 2022, p. 1).

In the update, the IASB acknowledged that through stakeholder engagements and research, they are aware that:

- IFRS 6 has allowed diversity in the accounting policies applied to exploration and evaluation expenditure to continue.
- information about those accounting policies is sometimes unclear.
- information about a company's reserves and resources is important for investors and is subject to differing regulatory requirements.
- companies have difficulties applying some IFRS Accounting Standards to extractive activities outside the scope of IFRS 6.

(Tadeu, 2022, p. 2)

However, the Board has tentatively decided to limit the scope of the extractive activities project to:

- developing requirements or guidance to improve the disclosure objectives and requirements in IFRS 6 relating to a company's exploration and evaluation expenditure and activities, with the objective of providing more useful information;
- removing the temporary status of IFRS 6 (invariably make it a permanent standard)

Whilst all 12 members of the Board agreed to the former, only 8 members agreed to the latter (IFRS, 2021).

And have decided to exclude the following from the project:

- the unit of account to apply to exploration and evaluation expenditure, which exploration and evaluation expenditures to capitalise and when to start and stop capitalising those expenditures;
- the challenges of applying Accounting Standards other than IFRS 6 to extractive activities and the accounting for collaborative arrangements; and
- the use and disclosure of reserve and resource information in financial statements

(Tadeu, 2022, p. 2)

3.0 Critical Analysis of the update

This section critically reviews the decision of the IASB as expressed in the brief as well as the personal reflections of the author in light of the existing literature.

3.1 Analysis of IASB's decision

Under the section titled "matter in the scope of IFRS 6" in the update brief, the IASB indicates that stakeholders, recent academic evidence and their own research have confirmed that diversity of accounting policies in the EI persists up to date. And the pivotal issues are about "…whether to capitalise exploration and evaluation expenditure, which types of those expenditures they capitalise, when they start and stop capitalising those expenditures, and the unit of account they apply to those expenditures" (Tadeu, 2022, p. 3). They also acknowledge that companies using IFRS 6 do not clearly disclose their accounting policies for E&E expenditure.

Owing to the nature of diversity and the importance of comparability, stakeholders suggested that IFRS 6 is amended to limit the extent of diversity and promote comparability of accounts. Regardless of these, the IASB claims they "did not find evidence of significant financial reporting problem" (p. 3) and that the diversity could reflect company-specific facts and circumstances. The IASB therefore concludes that changes to IFRS 6 could be disruptive. We find the reasoning and conclusion of the IASB very alarming and inconsistent with what the Board stands for. First of all, what other evidence does that Board need apart from those reported by stakeholders, academic research and their own research? It is clear that their conclusion is not based on the evidence available. Because though their evidence indicates existence of a problem which deserves attention, they decide to describe the evidence as not significant enough to warrant attention from them. What will make evidence significant for them? Which evidence do they have apart from what is already in the public domain which support their conclusion? If the Board is privy to any evidence which the general public is not aware, it would be great they make them available to support their decision.

Secondly, why would the Board decide to remove the temporary status for a standard which has permitted and codified existing diversity? No wonder, 4 of its own members of the Board did not agree to that decision.

Much as the decision of the Board is unexpected based on existing literature, it should not be surprising (see Cortese and Irvine, 2010; Cortese, 2011; Cortese, 2013; Cortese, Irvine & Kaidonis, 2007; Cortese, Irvine & Kaidonis, 2009; 2010; Georgiou, 2004; Nichols, 2012). One study which can offer insight into what is happening now is that of Cortese and Irvine (2010). In their study, they examine the role of powerful entities and coalitions in shaping international accounting standards and focused on how the IASB developed IFRS 6. The authors found that though the successful efforts method was endorsed by majority (78%) of the constituents who responded to the Issues Paper, the final outcome retained all the diverse methods (p. 13). Cortese and Irvine (2010) concluded that the differences between the visible inputs and outputs of the standard setting process indicates the existence of a "black box" which is the powerful extractive companies and their coalitions that covertly influenced the IASB's decision to retain all the diverse methods. This is just one of the many studies in the extant literature. Is what we seeing a repeat of the past? Where evidence points to direction, but decision is based on something else. We will leave this to the judgement of readers.

On page 4, it states "Many investors told us that information about exploration and evaluation expenditure is very important but, despite this, most indicated that the differences in accounting for exploration and evaluation expenditure is not a very significant concern for them, and they can manage this diversity." It is shocking for anyone to argue that the use of diverse accounting methods to account for E&E expenditure does not have significant effects on reported figures and as such not a very significant concern. For instance, in 2004 Premier Oil, in preparation to adopt IFRS, changed its accounting method from full cost to successful efforts and this resulted in the company restating its profit from $44 million to $22 million (Neveling, 2005 as cited in Cortese, Irvine & Kaidonis, 2010, p. 77). Another, example is that of Anadarko Petroleum Corporation when it acquired Kerr-McGee in 2006 as described below:

> Kerr-McGee, acquired by Anadarko Petroleum Corporation in 2006, was one of the world's largest independent oil and gas companies (Kerr-McGee, 2006). Immediately before it was acquired, Kerr McGee spent US$407 million on exploration and evaluation activities, which were accounted for using the full cost method (Kerr-McGee, 2005). In 2006 when the acquisition took place, Anadarko also used the full cost method to account for its pre-production activities (Anadarko Petroleum Corporation, 2006). During 2007, however, the company switched its method of accounting for oil and gas exploration and development activities to the successful efforts method (Anadarko Petroleum Corporation, 2007). This change in accounting policy required an adjustment to the financial statements for the 2006 reporting year, resulting in a downward restatement of income by US$322 million and a decrease of US$2,265 million in reported retained earnings, which represented twenty-five percent of the total retained earnings of the company (Anadarko Petroleum Corporation, 2007)
>
> (Cortese, 2013, pp. 52-53)

Besides these, using a simple example, how would fully capitalising say £200 million incurred on exploration and evaluation in the financial report and fully expensing it, not have significant impact on the reported results and hence should not an issue of concern to users of such reports. Empirical evidence also shows the value relevance of E&E expenditure (Zhou, Birt & Rankin, 2015) as well as the value relevance of the different accounting methods (see Bryant, 2003; Misund, 2015). They suggest diversity of accounting policies can influence decision and the choice of information users rely on. With this, it is completely misleading for one to argue that the issue of diverse accounting policy should not be an issue of concern because it does not have significant effect. Consistent with Nichols (2012), it could be that the IASB is being subjected to significant political pressure which is influencing their decision, or the Board has decided to take the easier route to avoid any intense oppositions and lobbying from the powerful player in the EI.

Moreover, if the IASB accepts that diversity of accounting policies in the EI is well-established as described in page 3 and permit it to continue then it is variably saying the qualitative characteristic of comparability is not relevant in the EI. This will be a recipe for disaster for financial reporting and the future of IFRSs since other specialised industries such as insurance, pharmaceutical etc can also argue same for their industries.

Lastly, investors saying "they can manage this diversity" should suggest to the Board that, they are ready to compromise if they cannot help them. This compromise may be less reliance on financial reports, and this should be worrying for the Board.

3.2 Analysis of Author's reflection

In addition to the decision of the Board expressed in the update, the author, Tadeu Cendon, also expresses his personal opinion on some of the issues and we devote the following section analysis his reflections. In discussing the reasoning behind the IASB's decisions, Tadeu contends that his initial view about the diversity of accounting policies in the EI was that it requires attention but after participating in a meeting with investors, "…there wasn't a clear message from them that this was something we should resolve. Instead, many investors said they would prefer us to improve the disclosure requirements rather than address the diversity in accounting policies." (Tadeu, 2022, p. 2).

His personal reflection is questionable in several respects. First, it is worth emphasising that according to Chapter 1 of the 2018 Conceptual Framework for Financial Reporting, the general purpose of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity (IASB, 2018). From this, it is clear that financial reports serve the needs of wider stakeholders not only investors. Why would stakeholder engagements and research inform the Board that there is diversity in practice, accounting policies used are unclear, information regarding reserves and resources are important, yet still Tadeu thinks the decision of the investors who were in that meeting is superior to what the masses (stakeholders) are saying. Is he in anyway assuming the interests of the other stakeholders are not as important as those of the investors? If that is the case then, it is clearly inconsistent with the general purpose of financial reporting as provided in the revised Conceptual Framework.

Secondly, a critical look at the expression "there wasn't a clear message from them that this was something we should resolve" suggests that there was a message to some extent but not clear enough. But the issue should be, does the IASB think there is a problem? and does the problem need to be resolved? If the answers to these questions are yes, then regardless of the investors not stating it clearly, the issue should not be abandoned and dealt with.

It is shocking to note that Tadeu contends "many investors" but not all of them, said they prefer improvement to disclosure requirements rather than addressing the issue of diversity of accounting policies. Why would these investors not want the problem "completely resolved" but want it "pruned"? Is that what IASB want? Instead of dealing with the problem completely through harmonising the diverse practices, would increasing disclosure requirement for widely diverse practices be a solution to the problem? It seems the IASB is underestimating the extent of diversity of practices in the EI. In a recent study by Stadler and Nobes (2020), the authors identified that nine distinct methods are being used by extractive companies that adopt IFRS and underscored that there are even diversities within some methods. The question is, will increasing in disclosure remedy the situation? This is one question for all of us to reflect on. We are not saying increasing disclosure requirements is not good, but we think more needs to be done to resolve this age-long problem than just mere disclosures.

It is again disturbing to note that even in their decision to improve disclosures, the IASB have decided not to develop requirements or guidance for the use and disclosure of reserve and resource information in the financial statement with the claim that that is beyond the Board's remit. It looks as if the IASB does not want to get itself into any issue that seems complicated. In the past the IASB has borrowed ideas from other experts in addressing accounting issues why can't they do same for the EI? Can't the Board liaise with the relevant expert and develop what may be an acceptable guidance for all companies operating in this industry? Before the introduction of IASs/ IFRSs, nations had their own accounting standards but through hard work and consultations, IASs/IFRSs were introduced and currently IFRSs are being adopted in about 166 jurisdictions around the world (IFRS, 2018). So, if the IASB says information about a company's reserves and resources, which investors claim it is important to them, is subject to differing regulatory requirements and therefore beyond their remit, then this can be interpreted as an excuse to do nothing about an important matter because where there is a will there should be a way.

Lastly, their claim that costs of resolving the diversity in accounting policies outweigh the benefits is not well substantiated. It would be useful if the Board could elaborate more on what they are describing as the costs of resolving the issue else we are tempted to read other meanings into that. The claim that it would be disruptive is not convincing. For us, a well harmonised accounting practice for the EI though will come at a high cost, it will be extremely beneficial since it will enhance comparability of accounts, reduce the exercise of discretion in accounting treatment for E&E expenditure and results in financial reports that reflect the economic substance of companies' activities. For such an important industry which commands a lot of investment and contributes significantly to global economy, the efforts and time to be spent in achieving this would not go waste.

4.0 Conclusion and Recommendations

Our analysis allow us to conclude that the IASB's decision, to limit the scope of the extractive activities project by excluding some of the issues stakeholders find important as well as removing the temporary status of the IFRS 6, which has allowed the diversity to persist, is based on unexplained motives but not existing evidence. It could be that the IASB is being subjected to significant political pressure which is hindering their efforts, or it has decided to take the easier route to avoid any intense oppositions and lobbying. These are not justifiable reasons for the issue of diversity in the EI not to be resolved fully, therefore, we recommend that the IASB rescinds its decision and bring back onto the extractive activities project all the aspects they have excluded and work collaboratively with other experts and stakeholders to have this problem resolved once and for all.

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