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July 30, 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Discussion Paper on Extractive Activities.

Dear Board Members,

The “Comitê de Pronunciamentos Contábeis” - CPC¹ welcomes the opportunity to comment on the Discussion Paper, DP/2010/1 named Extractive Activities.

This response summarizes the views of our members, which may be supported by the opinions of external parties, sent to us for analysis and to enhance the discussion on the subject matter. We have also made efforts to encourage other external parties to send comments directly to the IASB.

As a general comment we would like to emphasize the importance of the extractive activities project for those who make use of financial statements of mining or oil and gas companies, prepared in accordance to IFRS as issued by the IASB. Indeed, we fully agree with the statement made in paragraph 1.15 of the Discussion Paper:

It is generally acknowledged that the most important information about an entity conducting extractive activities is information about the minerals or oil and gas reserves and resources under that entity’s control. Economic decisions that involve investing in, and supplying and lending to, entities conducting extractive activities are dependent on an understanding of the quantity and quality of reserves and resources under the control of the entity.

The lack of requirements for the disclosure of information related to reserves creates a gap that has been compensated by means other than through the preparation of financial

¹ The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).



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statements according to IFRS. In fact, the usefulness of those financial statements might be questioned if not accompanied by other supplemental information.

Therefore, we strongly suggest the Board to include the extractive activities project in its technical agenda as soon as possible, in order to avoid postponing even further the issuance of an IFRS for both mining and oil and gas sectors.

If IASB decides to include the extractive activities project in its technical agenda, it is our opinion that convergence to US GAAP should be taken into account when deciding how mining or oil and gas companies should recognize, measure and disclose upstream operations. For instance and considering that Brazil has strong operations in the Oil & Gas sector, specially developing upstream activities, significant and material expenditures that are expensed when incurred will start to be capitalized without technical definition about how such expenditures might be associated with reserves.

Please see our detailed comments on the Board's questions in the Appendix to this letter.

If you have any questions about our comments, please contact Mr. Geraldo Toffanello² (geraldtoffanello@gerdau.com.br), coordinator of a working group constituted to study any proposal-stage literature issued by the IASB.

Yours sincerely,

Edison Arisa Pereira
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Comitê de Pronunciamentos Contábeis (CPC)

² Mr. Geraldo is also member of the IFRS Advisory Council



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Appendix - Consultation Questions

Question 1 – Scope of extractive activities

In Chapter 1 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 extractive activities? If so, please explain what other activities should be included within its scope and why.

Comments on Question 1

We are not aware of the existence of other activities that could be considered similar to those executed in the upstream operations of the mining and oil and gas industries. However we would like to emphasize the importance of having a scope that clearly defines the boundaries within which activities would still be considered upstream: vertically integrated mining or oil and gas companies might need such guidance at end of its production phases.

Also, regulatory frameworks applicable in some countries may raise doubts as to whether the activities executed by mining or oil and gas entities would fall into the scope of an extractive activities IFRS or if they should be merely treated as ordinary service contracts.

Question 2 – Approach

Also in Chapter 1, the project team proposes that there should be a single accounting and disclosure model that applies to extractive activities in both the minerals industry and the oil and gas industry. Do you agree? If not, what requirements should be different for each industry and what is your justification for differentiating between the two industries?

Comments on Question 2

In our view, the accounting and disclosure models proposed by the project team in the discussion paper might be applicable to mining and oil and gas entities. However, combining the accounting and disclosure requirements of both industries into one single standard has its downsides.

The accounting for oil and gas upstream operations, for instance, is complex and current practices are based on standards replete in technical terms and real-life examples. This is unavoidable, due to the highly specialized activities that need to be conducted. We wonder how a single standard could cover both industries without being vague when



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setting its requirements. Additionally, we do not believe that oil and gas companies are comparable with mining companies and neither do investors and analysts.

Therefore, we suggest that mining and oil and gas industries should have separate standards. If they were to be combined, we believe that consideration should be made to extend the scope to consider industry specific issues in both areas.. We have also made criticism and suggestions related to the accounting and disclosure models proposed by the project team (please see our comments to the next questions).

Question 3 – Definitions of minerals and oil and gas reserves and resources

In Chapter 2 the project team proposes that the 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) should be used in an IFRS for extractive activities. Do you agree? If not, how should minerals or oil and gas reserves and resources be defined for an IFRS?

Comments on Question 3

In general, we agree with proposal that specific reserve and resource definitions should be consistently applied by mining or oil and gas companies reporting under IFRS – not specifying which definitions extractive companies should use would cause a considerable lack of comparability among them. However, we do have the following concerns about the proposition that the CRIRSCO template and the PRMS definitions should become mandatory under IFRS:

a) Industry and market regulators

We are concerned that requiring the CRIRSCO template and the PRMS definitions might increase the level of work extractive entities are subject to, considering that industry and market regulators may already have their own requirements. In Brazil, for instance, oil and gas companies are required to present to the national regulatory agency the quantity of reserves they are entitled to extract, using for estimations the definitions of the Society of Petroleum Engineers effective until 1997. If the oil and gas company is listed in the US, it must also comply with the requirements and definitions of Regulation S-X.

Considering this scenario we do understand that is strictly important that both FASB and IASB align their views, in order to not bring on additional work for companies and even misunderstandings for the readers.



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b) Assuming third party definitions

Even though we agree with the premise that the IASB does not have the necessary technical expertise to develop a comprehensive set of reserve and resource definitions we are concerned about the implications of having this responsibility being delegated to third parties. We are not aware of other situations in which such an approach was adopted.

Additionally, third party definitions may become out of date as new technology and techniques are developed, and the consequences of that should be considered by the IASB when reaching a conclusion on the approach to be adopted. Therefore, if the IASB decides to develop new reserve definitions or to become the custodian of existing definitions, we believe that a group of experts should be established in order to continuously evaluate whether such definitions could be considered up to date.

c) Economic assumptions

We are concerned about the consequences that adopting the CRIRSCO template and the PRMS definitions could have when it comes to comparing different extractive companies. Since economic assumptions used for estimations are entity-based projections that could significantly affect the quantity of reserves a company is entitled to extract, users of financial statements could be misled in their decision-making processes.

We do not believe that the disclosure of the economic assumptions used could solve this problem (please see our comments to question 9). One solution would be the use of standardized economic assumptions for estimation of reserve quantities, as required today by the SEC for US and foreign registrants. After the adoption of the new rule on modernization of oil and gas reporting, it is our opinion that SEC definitions became considerably closer to PRMS definitions, in terms of technical assumptions.

If the IASB prefers not being attached to the definitions of the US securities regulator, it could set requirements in order to guarantee that the technical assumptions of the CRIRSCO template and the PRMS definitions should be used, but those requirements should also standardize economic assumptions inherent to the estimation process.

Please notice that our suggestion is strictly related to the estimation process that would result in the reserve quantities to be disclosed. In our view, impairment and DD&A (depreciation, depletion and amortization) of long lived assets should not be based on standardized measures – and in those cases we do not believe it would be costly for extractive entities to convert the economic assumptions of a model that works with the same technical assumptions and in which inputs have already been made.



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Question 4 – Minerals or oil and gas asset recognition model – recognition

In Chapter 3 the project team proposes that legal rights, such as exploration rights or extraction rights, should form the basis of an asset referred to as a 'minerals or oil and gas property'. The property 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 each be treated as enhancements of the legal rights. Do you agree with this analysis for the recognition of a minerals or oil and gas property? If not, what assets should be recognised and when should they be recognised initially?

Comments on Question 4

From our analysis of the discussion paper we understood that the proposals made by the project team for the recognition of minerals or oil and gas assets have a great level of similarity to a variation of the successful efforts method called the area-of-interest approach³. Under that approach, an area-of-interest would be represented by a cost center within which all pre-discovery costs incurred (such as dry holes and geological & geophysical costs) would be capitalized.

The area-of-interest approach was rejected by the FASB on the grounds that delineation of the boundaries of cost centers would unavoidably lead to significant differences of practice among extractive entities. Apparently, the project team's proposal would minimize this problem by defining the unit of account applicable for extractive activities.

The FASB was also concerned about the consequences of allowing indefinite deferral of pre-discovery costs. We agree that this represents a major disadvantage of the area-of-interest approach. In Brazil, for instance, offshore pre-discovery costs of oil and gas companies could remain capitalized for many years until exploratory activities are concluded. We believe that reaching an understanding on how much this could compromise the financial reporting of extractive activities is crucial for defining the accounting model that should be required under IFRS.

Requiring capitalization of dry holes could also reduce one's capacity to evaluate the operational performance of extractive companies and how successful they were in discovering reserves.

³ Paragraphs 103, 190, 191, and 192 of SFAS 19: Financial Accounting and Reporting by Oil and Gas Producing Companies. US GAAP codification did not incorporate these paragraphs.



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In summary, we have serious concerns about the practical application of the project team's proposal on asset recognition. Conceptually, it is still unclear for us how the association of new information with the value of legal rights over an area implies that all pre-discovery costs should be capitalized. After all, it is generally presumed that the realization of extractive assets occurs through the extraction of reserves – if this was not the case, impairment testing of exploratory property should be based on the current market value of the associated legal rights, taking into account all relevant information gathered so far (please see our comments on question 7).

Therefore, unless further information is produced on this matter, we suggest that cost capitalization in an extractive activities IFRS should be based on the successful efforts method, as required today under US GAAP. In our view, this highlights the need for a converged standard in this area, and we encourage the IASB to seek to conduct this project jointly with the FASB.

Question 5 – Minerals or oil and gas asset recognition model—unit of account selection

Chapter 3 also explains that selecting the unit of account for a minerals or oil and gas property involves identifying the geographical boundaries of the unit of account and the items that should be combined with other items and recognized as a single asset.

The project team's view is that the geographical boundary of the unit of account would be defined initially on the basis of the exploration rights held. As exploration, evaluation and development activities take place, the unit of account would contract progressively 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. The project team's view is that the components approach in IAS 16 Property, Plant and Equipment would apply to determine the items that should be accounted for as a single asset.

Do you agree with this being the basis for selecting the unit of account of a minerals or oil and gas property? If not, what should be the unit of account and why?

Comments on Question 5

In general, we agree with the project team's view on the selection of the unit of account for both exploration and extraction rights. However, the presumption that the unit of account would contract progressively may not always be true. Sometimes, when the continuity of an accumulation is verifiable, leaseholders may opt or be required to sign unitization agreements under which exploration rights are merged into a joint venture on



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a new participating area. Therefore, it is our opinion that the unit of account definition should cover all possible situations.

Question 6 – Minerals or oil and gas asset measurement model

Chapter 4 identifies current value (such as fair value) and historical cost as potential measurement bases for minerals and oil and gas properties. The research found that, in general, users think that measuring these assets at either historical cost or current value would provide only limited relevant information. The project team's view is that these assets should be measured at historical cost but that detailed disclosure about the entity's minerals or oil and gas properties should be provided to enhance the relevance of the financial statements (see Chapters 5 and 6).

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

Comments on Question 6

We strongly support the conclusion reached by the project team that mineral and oil and gas properties should be measured at historical cost. We have serious concerns about: (1) the excessive costs that would be necessary if extractive entities were expected to apply any other model such as fair value or current value; and (2) the reduced reliability of financial statement that would result from the adoption of these models, considering the great uncertainties that exist during the exploratory and evaluation phases.

Additionally, based on the analysis made by the project team on issues related to income recognition (paragraphs 4.79-82), we believe that the comprehensive income statement of mining and oil and gas companies would be severely distorted, impairing ones ability to understand the contribution of extractive assets to current period financial performance.

We would also like to address the following issues, related to the measurement of mineral or oil and gas assets:

a) DD&A

We have noticed that the discussion paper raises three issues on the DD&A subject (paragraph 4.48). We would like to position ourselves in advance as being favorable for the



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adoption of treatments similar to those already required under US GAAP. In that sense, we believe that: (1) the units of production formula should be based on physical units;⁴ (2) the production formula should be calculated on proved reserves only;⁵ and (3) when more than one commodity is extracted from the same property, the application of the unit of production formula should be based on a common unit of measure that considers the relative energy content of each commodity⁶

We also believe that some guidance should be provided to help companies that apply the developed and undeveloped classification of proved reserves, when using the unit of production formula. For instance, if a company depreciates its assets based on the quantity of developed proved reserves, common extractive property might have their carrying amounts excessively reduced in the beginning of their useful lives, while additional reserves are still undeveloped.

b) Long-term test

We are aware that during the exploratory phase, an oil and gas company may be required to run long term tests of extractive property for reserves to be proven. Consequently, costs incurred are already related to the development and production phases, but reserves have not been proven. This creates DD&A and revenue recognition issues that, in our opinion, should be addressed in a future IFRS on extractive activities.

c) Balancing arrangements

Another issue in the oil and gas industry is the accounting for balancing arrangements. In a typical balancing arrangement, each owner is entitled to an agreed-upon percentage of the property's total production, but in a given time, the amount of commodity sold by each owner may differ from its allowable percentage "to take". It is our opinion that an extractive activity IFRS should provide guidance on how these imbalances should be dealt with, since we believe that a large diversity of practices might exist.

Question 7 – Testing exploration properties for impairment

Chapter 4 also considers various alternatives for testing exploration properties for impairment. The project team's view is that exploration properties should not be tested for impairment in accordance with IAS 36 Impairment of Assets. Instead, the project team recommends that an exploration property should be written down to its recoverable amount in those cases where management has enough information to make this

⁴ ASC 932-360-35-6.

⁵ ASC 932-360-35-5.

⁶ ASC 932-360-35-5.



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determination. Because this information is not likely to be available for most exploration properties while exploration and evaluation activities are continuing, the project team recommends that, for those exploration properties, management should:

- (a) write down an exploration property only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full; and
- (b) apply a separate set of indicators to assess whether its exploration properties can continue to be recognised as assets.

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?

Comments on Question 7

Since we have suggested that the recognition of exploratory property should follow the successful efforts method (please see our comments on question 4), we do not agree with the project team's recommendations on impairment. Instead, we believe that impairment of exploratory property should be based on the requirements set by ASC 932-360-35⁷

We would like to point out, however, that the relevance of recoverability testing and recognition of impairment losses during exploratory phases might increase tremendously due to the proposals contained in the discussion paper. As we explained in our comments on question 4, exploratory property may remain capitalized for many years until a conclusion is reached on whether proved reserves exist.

In our view, testing the recoverability of exploratory property is sort of a grey area when it comes to extractive accounting. Therefore, we strongly suggest that any approach to be adopted should be as straight forward as possible. We agree that indicators can only help in reaching a conclusion on whether an asset should remain recognized.

In that sense, it is unclear for us how management's judgment could lead to the recognition of impairment losses. One line of research could be based on how companies determine the value of their interests over an area when negotiating farm-out or farm-in agreements. If the fair value of the legal rights over an area can be determined (based on how much one would be willing to pay to participated in it) testing the recoverability of exploratory assets might be possible, since they are presumed to be attached to these same legal rights.

⁷ The ASC Topic provides specific guidance for impairment testing of unproved properties during exploratory phases.



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Question 8 – Disclosure objectives

In Chapter 5 the project team proposes that the disclosure objectives for extractive activities are to enable users of financial reports to evaluate:

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

Comments on Question 8

We agree with the disclosure objectives proposed by the project team. The user of financial statements prepared by mining or oil and gas companies will be more capable to make informed decisions if those objectives are achieved. However, to do so, it is our opinion that a great level of comparability among different entities is necessary.

In that sense, we believe that the disclosure objectives for extractive activities should be to enable users of financial reports to evaluate and compare: (a) the value attributable to an entity's minerals or oil and gas properties; (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.

Please notice that our suggestion has further implications as we analyze and comment on the proposals made by project team for the disclosure of reserve quantities.

Question 9 – Types of disclosure that would meet the disclosure objectives

Also in Chapter 5, 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;



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- (d) a current value measurement that corresponds to reserves quantities disclosed with a reconciliation 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 production cash flows for the current period and as a time series over a defined period (such as five years).

Would disclosure of this information be relevant and sufficient for users? Are there any other types of information that should be disclosed? Should this information be required to be disclosed as part of a complete set of financial statements?

Comments on Question 9

In general we agree with the disclosure proposals made by the project team – they seem to be relevant and sufficient for users to evaluate the sustainability of entities engaged in extractive activities. We also recognize that most of the proposals already are somehow required by the SEC for US and foreign registrants. However, we would like to comment on some specific disclosure issues that came to our attention:

a) (i) Quantities of reserves

As summarized in table 5.1 of the discussion paper, the project team proposes that the quantity of proved reserves and proved plus probable reserves should be disclosed by mining or oil and gas companies, segregated by commodity and (where material) country or project.

We are concerned about the impact that such a requirement could have for large consolidated extractive companies. It can be affirmed that since those companies are more sustainable they would have a reduced need to present less reliable information in order improve prospects in general. Actually, the disclosure of probable reserves may result in the exposure of strategic information that some entities might not desire to make public. Additionally, quantities of probable reserves could change significantly from one period to another making it difficult for companies to explain the variations and for investors to understand them.

Therefore we suggest that the disclosure of probable reserves (and even possible reserves) should be optional.

(ii) Sensitivity analysis



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The project team proposes that a sensitivity analysis should be disclosed in order to show the sensitivity of the reserves quantity estimate to changes in the main economic assumptions. As explained in paragraph 5.60, such a requirement could be useful in helping to explain the uncertainties associated with the reserves quantity estimate made as at the reporting date.

We, however, strongly suggest that the disclosure of any sensitivity analysis should be optional, for following reasons: (1) as explained in our comments on question 3, we disagree with the proposal that economic assumptions should be projected and not standardized – with the standardization there would be a reduction in the level of uncertainties associated with the quantity of reserves reported; (2) disclosing the sensitivity analysis would not be enough to help the investor understanding how the estimation of economic assumptions affects the quantity of reserves of two different entities; and (3) the cost for producing such an analysis could be high.

(b) Main assumptions used

The project team proposes that the main assumptions used by an entity to estimate the quantity of its reserves should be disclosed. We disagree with that proposal, basically for same reasons that have made us disagree with any mandatory disclosure of sensitivity analysis. The only difference is that we do not believe that cost to disclose the main assumptions used would be considerably high.

(c) – (e) No comments

f) Time series of cash outflows

The project team proposes that exploration, development and production cash outflows that were made in the current and prior periods should be disclosed. In that sense, a time series of five years (possibly) should be provided. We would like to suggest that if such requirement becomes part of an IFRS for extractive activities, transitional provisions should also be included in order to give time for entities to accumulate the time series.

Other -- Inclusion of disclosures in the financial statements

The project team proposes that reserve information should be disclosed on a basis similar to IAS 41's requirement to disclose physical quantities of biological assets. By doing so, reserve information could be disclosed elsewhere in information published with the financial statements. We fully support this approach.

Other -Countries that prohibit the disclosure of reserve information



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We are aware that in some countries, governments might prohibit mining or oil and gas companies to disclose the quantity of reserves they are entitled extract (even though legally). The reasons for that may sometimes be based on the assumption that the reserves belong to the local government (until extraction occurs) and should not be presented in anyway by private companies. We believe that in such cases a standard on extractive activities should exempt companies from disclosing reserve information.⁸

Other - Income statement presentation

Based on our suggestion that the recognition of exploratory costs should occur in a manner similar to the requirements of ASC 932, under US GAAP, we propose that an extractive activities IFRS should also require extractive entities to disclose, in their income statements, the amount of exploratory costs expensed during a reporting period.

Other - Operational risks

We believe that an Extractive Activities IFRS should require an extractive entity to disclose a qualitative analysis on the risks associated to its upstream operations. In our view, this would be in line with the disclosure objectives set by the project team in the discussion paper.

Question 10 – Publish What You Pay disclosure proposals

Chapter 6 discusses the disclosure proposals put forward by the Publish What You Pay coalition of non-governmental organisations. 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 some categories of payments to governments might be difficult (and costly) for some entities, depending on the type of payment and their internal information systems.

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

Comments on Question 10

⁸ A similar exemption may be found in ASC 932-235-50-11.



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The members of the CPC fully support initiatives that serve to improve governance and promote sustainable development in countries where mineral and hydrocarbon reserves are located.

However it is our opinion that the disclosures related to the PWYP proposals do not fully comply with the disclosure objectives proposed by the project team in Chapter 5 and should not become mandatory as part of the financial reporting procedures of mining or oil and gas companies.

We believe that many issues related to materiality and confidentiality would be raised if such disclosures were to be required for financial statements prepared in accordance to IFRS and the benefits for the investors of extractive companies would be minimal. In summary, it is our view that PWYP disclosures should be kept outside the scope of financial reporting and companies could (and should) adopt them through other means such as corporate social responsibility reports or sustainability reports published by.