

Meeting: IPSASB Consultative Advisory Group
Meeting Location: Virtual Meeting
Meeting Date: June 14, 2021

Agenda Item 3

For:
 Approval
 Discussion
 Information

NATURAL RESOURCES

Project summary	The objective of the natural resources project is to develop a Consultation Paper, then one or more Exposure Drafts to address the issues relating to the recognition, measurement, presentation and disclosure of natural resources.	
Meeting objectives	Topic	Agenda Item
Discussion Items	Natural Resources	3.1
Other supporting items	Appendix A: IPSASB Due Process Checklist (condensed to included portions relevant to the CAG)	3.2
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NATURAL RESOURCES

Background

1. As noted in the [Natural Resources Project Brief and Outline](#), due to the prominence of natural resources in some jurisdictions, as well as the growing focus on sustainability and the effective management of natural resources, the IPSASB decided that it would be in the public interest to develop guidance on natural resources. The objective of this committed project is to develop guidance that will provide better information to enable transparency and accountability in how these natural resources are used and managed.
2. At the June 2019 meeting, the CAG advised the IPSASB regarding the potential scope of the project, potential approaches to incorporate IFRS 6, *Exploration for and Evaluation of Mineral Resources*, into IPSAS, as well as the proposed communication plan for the natural resources project. This input has helped the Natural Resources Task Force and the IPSASB set out the plan for the project overall and progress the Consultation Paper (CP) currently under development.
3. When developing guidance, two challenging issues have been identified:
 - (a) **General description of “natural resources”:** Staff have developed a description which differentiates between resources that are considered “natural” (i.e., in its natural state) and those that have been subject to human intervention. The intent is to develop guidance that differentiates items that are commonly referred to as “natural resources” (which are not currently addressed in IPSAS) from those which are not already addressed by existing IPSAS. Does the proposed general description appropriately achieve this differentiation?
 - (b) **Existence uncertainty:** Because some natural resources are not readily observable or accessible in their natural state, it may be difficult to ascertain the existence of these natural resources. How should this existence uncertainty be considered when developing guidance on recognition of natural resources as assets in the financial statements?

Issue 1: General Description of Natural Resources

4. In the Natural Resources CP, the IPSASB has developed a proposed general description of natural resources. A formal definition of natural resources may be developed later in the project based on constituent feedback and once the IPSASB has formulated more Preliminary Views (PVs).
5. IPSAS currently does not have explicit guidance on natural resources. Therefore, by using a principled approach to develop a general description of natural resources and by proposing accounting guidance for these described items, the project effectively fills a gap in IPSAS literature and achieves the IPSASB's public interest focus.

Proposed General Description of Natural Resources

6. To develop this general description, the CP drew from definitions of natural resources in more general, non-technical sources such as the plain English definition as well as definitions from economic texts. The general description also draws from international statistical standards such as the GFSM 2014 and 2008 SNA, as well as jurisdiction-specific accounting frameworks such as the

Standards of Generally Recognized Accounting Practice from South Africa (South African GRAP) and the standards issued by the Federal Accounting Standards Advisory Board (FASAB).

7. Based on the key aspects that are common among the above definitions, a natural resource can be generally described as an item which has the following attributes:
 - (a) Is naturally occurring;
 - (b) Remains in its natural state; and
 - (c) Is a resource as described in the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework).
8. Naturally occurring means that the resource came into existence without actions of humankind.
9. To remain in its natural state, a natural resource must not have been subjected to human intervention. The CP currently includes three natural resources within its scope: subsoil resources, living resources and water. The specific actions which are considered human intervention vary for each of the in-scope natural resources:
 - (a) For subsoil resources, the item remains in its natural state until it has been extracted from the ground by human actions;
 - (b) For living resources, human intervention refers to interference by humans in the living resource's natural biological transformation.¹ Human intervention encompasses not only harvesting a living resource, but also modifying the living resource's natural biological transformation prior to its harvest;² and
 - (c) Water remains in its natural state until it has been extracted by human actions.
10. Only the specific items of a natural resource which have been subject to human intervention are no longer in their natural state. For example, if a number of trees have been harvested from an uncultivated forest, only the harvested trees have been taken out of their natural state. The remaining trees in the uncultivated forest are still considered a natural resource, as they have not yet been harvested.
11. Another attribute of natural resources is that they must be a resource as described in the Conceptual Framework—that is, they are capable of generating economic benefits or have service potential.³ When considering this characteristic along with the above discussion on remaining in their natural state, items can only be considered natural resources if they are capable of being developed, extracted, harvested, or collected for their economic benefits or service potential, *but have not yet been subject to human intervention*.
12. These attributes will be useful in setting boundaries for what are included or excluded from the project. The first and second attributes both reinforce the notion that this project only considers

¹ Paragraph 9 of IPSAS 27, *Agriculture*, states, "Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset."

² Paragraph 9 of IPSAS 27 defines harvest as "the detachment of produce from a biological asset or the cessation of a biological asset's life processes." The term can apply to both plants and animals.

³ Conceptual Framework, paragraph 5.7.

resources which have not been subjected to human intervention. This delineation is important as it accomplishes the goal of describing natural resources in a way that fills the gap in current IPSAS literature. That is, a “natural resource” as described above excludes items which have already been extracted, developed, harvested, or collected and are likely within the scope of existing IPSAS such as IPSAS 12, *Inventories*, or IPSAS 27, *Agriculture*.

13. The last attribute is important as it aligns the general description of natural resources with the recognition criteria in the Conceptual Framework.⁴ That is, if the item is not a resource, it will not be possible for the item to be recognized as an asset. However, the lack of recognition and measurement in the financial statements does not preclude the IPSASB from proposing presentation of information regarding natural resources in either the note disclosures to the financial statements or as supplementary information in an entity’s broader General Purpose Financial Reports (GPFRs).
14. It should be noted that the description of natural resources from economic literature points to the fact that natural resources embody economic benefits or service potential, which is consistent with the definitions from plain English, statistical accounting, and South African GRAP. However, it also points to the fact that a natural resource may lead to potential economic outflows and the creation of costs. During the IPSASB staff’s preliminary outreach activities, a number of constituents also suggested for the IPSASB to consider the issue of costs in the CP, in particular the costs of exploration, evaluation, development, and extraction. Although the costs of activities related to natural resources do not strictly fall in line with the above description of natural resources, the subsoil resources chapter of the CP considers the recognition of the costs of related activities in the context of subsoil resources⁵. For other natural resource-related costs which do not result in the potential recognition of an asset, such potential outflows are addressed by IPSAS 19, *Provisions, Contingent Liabilities, and Contingent Assets*.

Questions for the CAG 1

The IPSASB proposes that a natural resource can be generally described as an item which:

- (a) Is naturally occurring;
- (b) Remains in its natural state; and
- (c) Is a resource as described in the IPSAS’s Conceptual Framework.

The above description sets out the scope for the project and is meant to address items which are generally understood as natural resources.

For items which fit within the above description but do not meet the recognition criteria, the Natural Resources Task Force proposes that information on these items be provided in note disclosures within the financial statements or as supplementary information in the broader GPFRs (e.g., information provided

⁴ Per paragraph 6.2 of the Conceptual Framework: “The recognition criteria are that: an item satisfies the definition of an element; and can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.” For a natural resource to be recognized as an asset, the item must meet the definition of an asset, which is defined in paragraph 5.6 of the Conceptual Framework as, “A resource presently controlled by the entity as a result of a past event.”

⁵ The detailed discussion in the CP notes that certain exploration, evaluation, and development costs could be capitalized as non-current assets, while direct extraction costs are typically capitalized as inventory.

through the application of the IPSASB's Recommended Practice Guidelines). Do you foresee any challenges associated with this proposed approach?

Interaction of the Above General Description with the Scope of the Natural Resources CP

15. The in-scope natural resources—subsoil resources, living resources, and water—fit within the above general description of natural resources when they meet the three attributes. These items meet the first and second attributes, as only the resources in their natural state—i.e., unextracted subsoil resources, uncultivated and unharvested living resources, and unextracted water—are considered in this project. Once removed from their natural state, these resources would be considered inventories or biological assets and agricultural produce.
16. Furthermore, the Conceptual Framework already alludes to the fact that subsoil resources, living resources and water can all be considered resources.⁶

Issue 2: Uncertainty and Asset Recognition

17. As noted in paragraph 2(b), some natural resources are not readily observable or accessible in their natural state. For such natural resources, the uncertainty over their existence could lead to challenges in their recognition as an asset in the financial statement.
18. The Conceptual Framework identifies two sources of uncertainty that are relevant in the recognition of an element: uncertainty over the existence of an element and measurement uncertainty.
 - (a) **Uncertainty over the existence of an element** is addressed by considering all available evidence, facts, and circumstances at reporting date to make a neutral judgement about whether an item satisfies all the essential characteristics of an element. In other words, uncertainty over the existence of an element should be considered in the first recognition criterion when determining whether the item satisfies the definition of an element.⁷
 - (b) **Measurement uncertainty** is the uncertainty associated with the measurement of many amounts presented in the financial statements.⁸
19. Both existence uncertainty and measurement uncertainty can have a significant impact on the recognition of certain natural resources as an asset. However, the Conceptual Framework requires the two types of uncertainty to be addressed differently.
20. When finalizing chapter 6 of the Conceptual Framework, the IPSASB decided that a standardized probability threshold should *not* be adopted for recognition purposes. Rather, the IPSASB concluded that an assessment of all available evidence in determining whether an element exists and takes account of uncertainty about the flows of service potential or the ability to generate economic benefits is a more appropriate approach. The IPSASB also noted that existence uncertainty could relate to more than one specific characteristic of an element.⁹

⁶ Paragraph 16 in the Preface to the Conceptual Framework refers to “natural... resources such as mineral reserves, water, fishing grounds, [and] forests.”

⁷ Conceptual Framework paragraphs 6.5 and BC6.2.

⁸ Conceptual Framework paragraphs 6.8.

⁹ Conceptual Framework, paragraphs BC6.3-BC6.7.

21. The Conceptual Framework's basis for conclusions explains that, when determining if an item meets the definition of an asset, there could be uncertainty over whether a resource presently exists, uncertainty over whether the entity controls the resource, or uncertainty over the existence of a past event giving rise to control. All three sources of uncertainty should be considered when determining if the item meets the definition of an asset.
22. Regarding measurement uncertainty (i.e., the uncertainty over the *amount* of service potential or economic benefits represented by the element), the Conceptual Framework states that such uncertainty is reflected in the measurement of the element. Therefore, once it has been determined that an element can be measured in a way that achieves the qualitative characteristics and takes into account constraints on information, an entity should also assess whether a measurement technique can be used to appropriately reflect the uncertainty inherent within the information available at reporting date. In rare instances, an item is not recognized if the level of measurement uncertainty in a single point estimate is so large that the relevance and faithful representativeness of the measure become questionable.¹⁰
23. For some natural resources, a significant source of uncertainty is attributable to the existence of the resource. For example, subsoil resources are typically underground and cannot be directly observable or readily accessible. Given this, one of the most significant hurdles to recognition, is existence uncertainty of the natural resources.

Question for the CAG 2

The IPSASB's Conceptual Framework notes that uncertainty over the existence of an element should be considered when determining whether the item satisfies the definition of an element.

Do you agree that the main challenge regarding the accounting for natural resources is the impact of existence on their recognition? If yes, are there factors the IPSASB should consider from the perspective of its constituents as recognition is a significant challenge?

¹⁰ Conceptual Framework paragraphs 6.6 and 6.8.

Appendix A: IPSASB Due Process Checklist (condensed to included portions relevant to the CAG)

Project: Natural Resources

#	Due Process Requirement	Yes/No	Comments
A. Project Brief			
A1.	A proposal for the project (project brief) has been prepared, that highlights key issues the project seeks to address.	Yes	The IPSASB considered the project brief at its March 2020 meeting (see Agenda Item 10).
A2.	The IPSASB has approved the project in a public meeting.	Yes	See the minutes of the March 2020 IPSASB meeting (section 10) .
A3.	The IPSASB CAG has been consulted on the project brief.	Yes	At the June 2019 meeting, the CAG was consulted on the following topics, which fed into the development of the project brief: <ul style="list-style-type: none"> • Potential scope of the project • Potential approaches to incorporate IFRS 6 into IPSAS • Proposed project communication plan (See the Agenda Item 6).
B. Development of Proposed International Standard			
B1.	The IPSASB has considered whether to issue a consultation paper or undertake other outreach activities to solicit views on matters under consideration from constituents.	Yes	In the project brief that was approved at the March 2020 IPSASB meeting, the IPSASB agreed that a CP should be developed as part of this project. (See Agenda Item 10).
B2.	If comments have been received through a consultation paper or other public forum, they have been considered in the same manner as comments received on an exposure draft.		N/A
B3.	The IPSASB CAG has been consulted on significant issues during the development of the exposure draft.		N/A

#	Due Process Requirement	Yes/No	Comments
<i>D. Consideration of Respondents' Comments on an Exposure Draft</i>			
D4.	The IPSASB CAG has been consulted on significant issues raised by respondents to the exposure draft and the IPSASB's related responses.		N/A
D5.	Significant comments received through consultation with the IPSASB CAG are brought to the IPSASB's attention. Staff have reported back to the IPSASB CAG the results of the IPSASB's deliberations on those comments received from the CAG.		N/A

Appendix B: Links to Other Documents

1. This appendix provides links to document which may be useful to CAG members in providing a background related to the project.
 - (a) [Natural Resources project page](#)
 - (b) [Natural Resources: Project Brief and Outline](#)
 - (c) Paper from the June 2019 CAG Meeting: [Natural Resources in the Public Sector](#)
 - (d) [Discussion of Natural Resources at the June 2021 IPSASB meeting](#) (See Agenda Item 5)