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Chair
IPSASB

Submitted online

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Consultation Response - Natural Resources

Dear Mr Carruthers,

Accountancy Europe is pleased to provide you with our comments on the IPSASB's public consultation, *Natural Resources*.

1. As we stated in our response to the IPSASB's consultation on *Advancing Public Sector Sustainability*, we agree with the IPSASB's decision to hold back the *Natural Resources* consultation to link it to broader sustainability issues and to incorporate within it elements of sustainability. However, we believe that the IPSASB could be more ambitious.
2. We believe that the Natural Resources project offers the IPSASB a unique opportunity to connect financial reporting to broader reporting issues. There is a link between the Natural Resources project and natural capital accounting and the potential to connect financial reporting of certain natural resources to carbon accounting of avoided emissions. This would encourage the recognition of the financial value of leaving certain natural resources in their original state and encouraging conservation thereof.
3. We appreciate the difficulties that the IPSASB faces in distinguishing 'natural resources' from both natural phenomena that have no fiscal value and with other assets of a similar ilk that are already included in existing IPSAS. However, we have considerable concerns that the criterion 'is in its natural state' will be very difficult to apply consistently when applied in practical circumstances. We have similar, if reduced, concerns about the 'is naturally occurring' criterion, especially as it applies to living resources.
4. In respect of sub-soil resources, we agree with the IPSASB's preliminary view that existence uncertainties can, and usually would, prevent the recognition of sub-soil resources.
5. We have concerns with the proposal of making the Recommended Practice Guidelines (RPGs) mandatory for Natural Resources. We believe that there is a need for public sector entities to provide management commentary that explains key matters in the general-purpose financial reports (and in other connected reports). However, we are not convinced that making the RPGs mandatory for Natural Resources alone is the best way to approach this.

We present our responses to the detailed questions below.

Preliminary View 1 Chapter 1

The IPSASB's preliminary view is that a natural resource can be generally described as an item which:

Is a resource as described in the IPSASB's Conceptual Framework;

Is naturally occurring; and

Is in its natural state.

Do you agree with the IPSASB's Preliminary View, particularly whether the requirement to be in its natural state should be used to scope what is considered a natural resource?

6. We agree that for a natural resource to be within the scope of this project it should be a resource as described in the IPSASB Conceptual Framework. It is possible that for natural resources the economic benefit or service potential may be broader or more distant than for other assets (i.e., such as the economic benefit of naturally occurring forest attracting tourists or the service potential of a forest in capturing carbon dioxide and generating oxygen) but we do not see this as an issue.
7. We also agree that in most cases natural resources are those that came into existence without the actions of mankind. Indeed, for subsoil resources and many of the potential water resources, it would be practically impossible for mankind to generate these assets.
8. However, the situation could be more complex with living resources. It is quite possible that mankind can generate living resources that share all the characteristics of living resources that have developed without the involvement of mankind. For example, trees of a type naturally occurring could be planted, or replanted, to increase the size of forest that would have been naturally occurring before sections were illegally logged. Wild animals could be bred to replace those illegally poached. If there was no intention to generate direct income from such resources (i.e., by logging or licenced game hunting) it would seem counter intuitive and, maybe even impossible, to distinguish between such resources and to account for them differently.
9. We understand the reasoning behind the third criterion, "in its natural state," but have issues with how this would work in practice, as we will discuss in SMC 1 below.

Specific Matter for Comment 1 – Chapter 1

The IPSASB's preliminary description of natural resources delineates between natural resources and other resources based on whether the item is in its natural state.

Do you foresee any challenges in practice in differentiating between natural resources and other resources subject to human intervention?

If so, please provide details of your concerns.

How would you envisage overcoming these challenges?

10. We understand that the criterion "in its natural state" provides a demarcation between assets recognised under the potential draft standard *Natural Resources* and those that are already covered by existing IPSASs, in particular by IPSASs 12 *Inventories*, 17 *Property, Plant and Equipment* and 27 *Agriculture*.
11. We do not see any significant issues with this being a relevant criterion for subsoil resources.

12. However, in respect of living and water resources this could be very difficult to apply in practice. At some point in history, most forests and many rivers in the world have had human intervention that modifies their quantity and/or quality'. It will be difficult to determine the point where such intervention crosses the threshold to change a resource from natural to being one potentially covered by another standard.
13. Additionally, alterations by mankind to one resource can have consequential effects on another resource that may be classified as a natural resource. For example, the Mekong River has been dammed in many sections to generate hydroelectricity. Does this mean that it can no longer be a 'natural resource' along its entire length? The damming is thought to be at least partially responsible for a reduction in the waters reaching the Tonle Sap Lake, of between 10 and 25%. Would this also prevent the Tonle Sap from being classified as a 'natural resource'?
14. Perhaps an alternative criterion would be that the asset is not being developed for exploitation. In this situation, the only economic benefits would be those derived from leaving the resource in its original state. As soon as the resource is earmarked for commercial exploitation it would be covered by other relevant IPSASs.
15. Another alternative could be to classify natural resources as those that have an indirect economic benefit or service potential. For example, this would differentiate farming livestock reared for direct economic benefit from wildlife whose service potential would be indirect – such as encouraging tourism or keeping plants under control. Equally, it would differentiate water held in reservoirs for consumption from water in rivers that provide indirect benefits such as cooling or as transport mechanisms for carbon dioxide sinks.
16. However, we acknowledge that concept of 'indirect' economic benefit or service potential would need considerable discussion within the Board and with stakeholders before it could be incorporated into an IPSAS, so perhaps this proposal is best seen as a longer-term project. In the meantime, the IPSASB should consult with its stakeholders as to how the criteria 'in its natural state' could be further refined and operationalised so as to achieve the most consistent application possible.

Specific Matter for Comment 2 – Chapter 1

The IPSASB noted that the natural resources project and sustainability reporting in the public sector are connected in that this project focuses on the accounting for natural resources while sustainability reporting may include consideration of how natural resources can be used in a sustainable manner.

In your view, do you see any other connections between these two projects?

17. We believe that the *Natural Resources* project offers the IPSASB a unique opportunity to connect financial reporting to broader reporting issues. We are not aware of another financial reporting focused project with such obvious links to broader sustainability issues – both in terms of ecological sustainability but also in terms of fiscal sustainability. In the private sector the links have tended to come from the ESG reporting side, and it has not always been easy to relate these to specific financial reporting disclosure requirements that are focused on investors and based on legal requirements.
18. It is apparent that the current approach proposed by the IPSASB already assists ecological sustainability. By setting strict recognition and measurement requirements (discussed in more detail in Preliminary View (PV) 2 onwards) it does not encourage widespread recognition of

resources on government balance sheets that, from the point of view of greenhouse gas (GHG) emissions, would be better left unexploited.

19. However, we believe that the IPSASB could go further. There is an obvious connection between the *Natural Resources* project and natural capital accounting, as exemplified by the EU's [INCA](#) and the [NCAVES](#) projects. At the bare minimum, it is an ideal opportunity to link financial reporting of certain natural resources to carbon accounting of avoided emissions. This would encourage the recognition of the financial value of leaving certain natural resources in their natural state and encouraging conservation thereof – perhaps by recognising or disclosing as an asset the present value of saved future costs.
20. Apart from the environmental advantages of preserving natural resources, there is a broader social value (that could potentially be monetised) of leaving natural resources in their natural state – for example, in improving the mental wellbeing of citizens.
21. Especially for countries that depend on the exploitation of natural resources for a significant source of their budget, there will be tension between the perceived fiscal sustainability that arises from the future exploitation of such assets and the environmental sustainability that arises from leaving them undisturbed.
22. The IPSASB could play a valuable role in leading this discussion and thereby help encourage the realisation that long term fiscal sustainability may be partly dependant on preservation, or at least, the sustainable exploitation of natural resources.

Preliminary View 2—Chapter 2

The IPSASB's preliminary view is that a natural resource should only be recognized in GPFS if it meets the definition of an asset as defined in the IPSASB's Conceptual Framework and can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons

23. In respect of financial reporting in general purpose financial statements we see no reason why natural resources should be treated different from any other asset. Consequently, we agree with the IPSASB's preliminary view.

Preliminary View 3—Chapter 3

*The IPSASB's preliminary view is that guidance on exploration and evaluation expenditures, as well as development costs, should be provided based on the guidance from IFRS 6, *Exploration for and Evaluation of Mineral Resources*, and IAS 38, *Intangible Assets*.*

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

24. We agree with the IPSASB's preliminary view that guidance on exploration and evaluation expenditures, as well as development costs, should be provided based on the guidance from IFRS 6, *Exploration for and Evaluation of Mineral Resources*, and IAS 38, *Intangible Assets*.

25. We cannot think of any public sector specificities that would necessitate public sector entities engaged in similar exploration and evaluation activities as their private sector counterparts departing from the accounting treatment applied by the private sector.

Preliminary View 4—Chapter 3

The IPSASB's Preliminary View is that IPSAS 12, IPSAS 17, and IPSAS 31 should be supplemented as appropriate with guidance on the accounting for costs of stripping activities based on IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

26. We agree with the IPSASB's preliminary view that that IPSAS 12, IPSAS 17, and IPSAS 31 should be supplemented as appropriate with guidance on the accounting for costs of stripping activities based on IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine.
27. Again, we have not identified any public sector specificities that would necessitate public sector entities engaged in similar activities as their private sector counterparts departing from the accounting treatment applied by the private sector.

Preliminary View 5—Chapter 3

The IPSASB's preliminary view is that, before consideration of existence uncertainty, an unextracted subsoil resource can meet the definition of an asset.

Do you agree with the IPSASB's Preliminary View?

Please provide the reasons supporting your view.

28. We agree with the IPSASBs preliminary view that, before consideration of existence uncertainty, unextracted subsoil resource can meet the definition of an asset.

Preliminary View 6—Chapter 3

The IPSASB's preliminary view is that existence uncertainty can prevent the recognition of unextracted subsoil resources.

Do you agree with the IPSASB's preliminary view?

Please provide the reasons supporting your view.

29. We agree with the IPSASB that, even with thorough geological surveys, there is usually substantial uncertainty as to whether subsoil resources exist. Consequently, we agree that existence uncertainty can prevent the recognition of unextracted subsoil resources (albeit certain costs in respect of establishing those reserves may be recognised as assets in where the recognition criteria are met).
30. This is why even 'proved' oil reserves (i.e. those estimated probability of recovery in excess of 90%) are not normally recognised as assets in the financial statements of private sector energy companies.

31. Consequently, it is difficult to imagine that reserves of subsoil assets would ever meet the recognition criteria for the financial statements of public sector entities using the same criteria as is used in the private sector.
32. Even if not recognised in the financial statements, it could be appropriate to disclose such reserves in broader financial reports, as is the case with the private sector. In this circumstance, if the reserves were to be disclosed, it would also be advisable that public sector entities are also required to disclose the potential direct costs related to the extraction of such reserves, and the indirect costs of the externalities of exploiting such reserves (for example, the climate cost of the reserves).

Preliminary View 7—Chapter 3

The IPSASB's preliminary view is that the selection of a measurement basis for subsoil resources that achieves the qualitative characteristics and takes account of constraints on information in the GPFRs may not be feasible due to the high level of measurement uncertainty. Based on this view, the recognition of subsoil resources as assets in the GPFS will be challenging.

Do you agree with the IPSASB's Preliminary View?

If not, please provide the reasons supporting your view.

33. We agree that there are substantial uncertainties in estimating the quantities capable of being extracted and the costs of doing so, as well as the rectification costs. Markets for many subsoil resources have also fluctuated considerably over the last ten years, making it very difficult to estimate the market value of the resources, especially given the typically long lead time from discovery to market. It is also likely that many fossil fuel subsoil resources will face a declining market over the long term as more power generation, industrial processes and heating switches to sources that emit less CO₂.
34. However, whilst we agree that selection of an appropriate measurement basis for subsoil resources may be challenging, it is still feasible. This on the presumption that an appropriate measurement basis is available and that sufficient information about any presumptions made during the measurement process are sufficiently disclosed in the financial statements to enable users to understand any limitations in the measurement basis used.

Preliminary View 8—Chapter 4

Based on the discussions in paragraphs 4.11-4.31, the IPSASB's preliminary views are:

It would be difficult to recognize water in seas, rivers, streams, lakes, or certain groundwater aquifers as an asset in the GPFS because it is unlikely that they will meet the definition of an asset, or it is unlikely that such water could be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in the GPFRs;

Water impounded in reservoirs, canals, and certain groundwater aquifers can meet the definition of an asset if the water is controlled by an entity;

Where water impounded in reservoirs and canals meets the definition of an asset, it may be possible to recognize the water in GPFS if the water can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in the GPFRs;
and

In situations where the financial capacity or operational capacity of a water resource cannot be reliably measured using currently available technologies and capabilities, the resource cannot be recognized as an asset in the GPFS.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons supporting your view.

35. We believe that control is the key constraint as to whether water resources can be recognised as an asset in GPFS. Rivers and seas, in particular, are usually trans-national and control over the resource may be difficult to demonstrate. This would even be the case at the source of a river, as a country has no control over the water cycle.
36. Consequently, we agree with the IPSASBs preliminary views that water impounded in reservoirs and canals may be recognised in GPFS if it can be measured, but that water in seas, rivers and streams is unlikely to meet the definition of an asset. The situation with lakes can be more complicated as they will often fall within national boundaries and may form part of, or be affected by, control of water resources. Often the distinction between a lake and reservoir is not obvious, so this would need to be examined on a case-by-case basis.
37. We also agree that existence uncertainty, particularly in respect of groundwater reserves, and measurement uncertainty can be sufficient to prevent the water resource being recognised as an asset in GPFS.
38. Finally, we agree with the IPSASB's preliminary view that where the financial or operational capacity of a water resource cannot be reliably measured it cannot be recognised as an asset in the GPFS.

Specific Matter for Comment 3—Chapter 5

Living organisms that are subject to human intervention are not living resources within the scope of this CP. The accounting treatment of those living organisms, and activities relating to them and to living resources, is likely to fall within the scope of existing IPSAS.

In your view, is there sufficient guidance in IPSAS 12, IPSAS 17, or IPSAS 27 on how to determine which IPSAS to apply for these items necessary?

If not, please explain the reasons for your view.

39. We believe that there is sufficient guidance in IPSAS 12 *Inventories*, IPSAS 17 *Property, Plant and Equipment* and, especially, in IPSAS 27 *Agriculture* to determine the treatment of living organisms subject to human intervention.
40. However, applying the guidance can be a somewhat circular process. For example, bearer plants are within the scope of IPSAS 17, but IPSAS 27 must be consulted to confirm this. A potential standard on *Natural Resources* including living resources will only make the situation more complex, especially for new adopters.
41. It could be useful to include in the Additional Guidance of the potential standard a more detailed version of the flowchart shown on page 43 of the public consultation. This would provide a process by which to direct the user to the relevant IPSAS to determine the accounting treatment for a particular category of living organism. This would include those living organisms that fall completely outside the scope of GPFS, as indicated in Figure 2, page 15, of the public consultation.

Preliminary View 9—Chapter 5

Based on the discussions in paragraphs 5.18-5.41, the IPSASB's preliminary views are:

- (a) It is possible for a living resource held for financial capacity to meet the definition of an asset, be measurable in a way that achieves the qualitative characteristics and takes account of the constraints on information in the GPFRs, and thus meet the criteria to be recognized as an asset in GPFS;*
- (b) If a living resource with operational capacity meets the definition of an asset, an entity will need to exercise judgment to determine if it is feasible to measure the living resource in a way which achieves the qualitative characteristics and takes account of the constraints on information in the GPFRs, and so meet the criteria to be recognized as an asset in the GPFS; and*
- (c) In situations where the financial capacity or operational capacity of a living resource cannot be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in the GPFRs using currently available technologies and capabilities, the living resource cannot be recognized as an asset in the GPFS.*

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

- 42. We agree with the IPSASB's preliminary view that it is possible for a living resource held for financial capacity to meet the criteria to be recognised as an asset in GPFSs. The same applies to those living resources held in an operational capacity, if a relevant and reliable measurement basis can be achieved.
- 43. We also agree that in circumstances where a relevant and reliable measurement basis cannot be achieved, the living resource cannot be recognised as an asset in the GPFS.

Preliminary View 10—Chapter 6

Based on the discussion in paragraphs 6.7-6.15, the IPSASB's preliminary view is that certain information conventionally disclosed in GPFS should be presented in relation to natural resources.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

- 44. For natural resources recognised as assets in GPFS, together with any associated liabilities, contingencies and commitments, we agree that at least an equivalent level of information (as outlined in paras 6.7- 6.15) should be disclosed as for other assets recognised in GPFS.

Preliminary View 11—Chapter 6

Based on the discussion in paragraphs 6.16-6.20, the IPSASB's preliminary view is that certain information conventionally found in broader GPFRs should be presented in relation to recognized or unrecognized natural resources that are relevant to an entity's long-term financial sustainability, financial statement discussion and analysis, and service performance reporting.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons.

45. For consolidated government financial reports, it can be argued that it is difficult to make sense of general-purpose financial reports without considering and reporting on fiscal sustainability.
46. The fiscal sustainability of many governments is at least partly dependent on the existence or exploitation of natural resources, and several are heavily dependent on such resources. Consequently, where natural resources play a large role in a country's fiscal sustainability it is axiomatic that information should be presented in respect of those recognised or unrecognised natural resources that are relevant to an entity's long-term financial sustainability, and that provide more background to analyse the financial statements and service performance reporting.
47. As mentioned above, there is potential friction between the disclosing information about unrecognised natural resources that may be very important to a country's fiscal sustainability but where the normal exploitation of them either releases GHGs (and other pollutants) or reduces the capacity to absorb GHGs and thereby reduces the likelihood of the country reaching its Paris Agreement targets.
48. Consequently, we believe that it is important to consider the potential benefits of non-exploitation of natural resources. This can be both in terms of direct financial benefits (e.g., increased tourism), indirect financial benefits (e.g., the climate transition costs saved by not releasing additional GHGs) and broader social benefits (e.g., an increase in a country's happiness index).
49. Land use change and forestry (LULUCF) is an important element of GHG emission reductions and will be part of a global reporting framework. However, this is not often included in governments' consolidated financial reports, so this could be an area where the IPSASB could play a valuable role and could conceivably be linked to the Natural Resources project.

Specific Matter for Comment 4—Chapter 6

The proposals in paragraphs 6.16-6.20 (Preliminary View 11) are largely based on the IPSASB's RPGs.

While these proposals are expected to be helpful to users of the broader GPFRs, the information necessary to prepare these reports may be more challenging to obtain compared to the information required for traditional GPFS disclosures. As noted in paragraph 6.17, the application of the RPGs is currently optional.

In your view, should the provision of the natural resources-related information proposed in Preliminary View 11 be mandatory? Such a requirement would only be specifically applicable to information related to natural resources.

Please provide the reasoning behind your view.

50. There is some support for making the RPGs mandatory in respect of *Natural Resources*. This is especially the case for jurisdictions that are heavily dependent on natural resources for fiscal sustainability. From a sustainability point of view, we are also aware that some countries that have reported on the exploitation of natural resources have seen such exploitation decrease.

51. However, as they currently stand, the RPGs are principle-based and high level. Consequently, they are not ideally suited to generate information that is relevant and comparable and that can be adequately assured.
52. We also believe that a tension arises from requiring preparers to link standards to guidance, where the due process for each may be different. We also believe that it is not good standard setting to mandate guidance for a few, or indeed one, standards only.
53. Additionally, there is an argument that many of the organisations that use IPSAS for their accounting will gain little benefit from preparing statements based on the RPGs – such as international organisations and lower levels of government. Making the RPGs mandatory for all public sector organisations, is, therefore, not supported by Accountancy Europe at this time.
54. This feeds into the broader argument about the mandatory inclusion of management commentary in the general-purpose financial reports of public sector entities. It is likely that stakeholders interested in the general-purpose financial reports would find useful management commentary that explains (and is consistent with) information presented in the financial statements (and other reports, such as fiscal sustainability reports or ESG reports). This commentary could be, at least in part, based on the RPGs but would need to be proportionate to the nature and scale of the entity concerned. This is an area that we would recommend that the IPSASB consider and should consider liaising with the IASB as it works on updating *IFRS Practice Statement 1: Management Commentary*.

Sincerely,



Olivier Boutellis-Taft
Chief Executive

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