

IPSASB Consultation Paper

Natural Resources

Response from the Chartered Institute of Public Finance and Accountancy

17 October 2022

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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Our reference/AFRF 221017

Submitted electronically

Consultation Paper, Natural Resources

CIPFA is pleased to present its comments on this consultation paper, which has been reviewed by members of CIPFA's Accounting and Financial Reporting Forum.

In CIPFA's view, this is a worthwhile project, and 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.

General comments

In progressing the project, the IPSASB has sought to address difficulties in distinguishing 'natural resources' from both natural phenomena that have no financial/economic value and from other resources with 'nature linked' characteristics that are already within the scope of IPSAS, and generally we agree with the proposals.

Defining natural resources

However, we are concerned that the criterion 'in its natural state' as currently articulated will be difficult to apply consistently. As a result of this, some clarification and refinement may be necessary. Having said this, as the Consultation Paper notes, there are many circumstances where recognition of resources as assets will not be appropriate, due to issues around control, existence uncertainty and measurement uncertainty, or the lack of an appropriate measurement basis. So it is less clear how the technical difficulties we are signposting are likely to be realised in practice.

Wider reporting

Perhaps the majority of the natural resources for which the public sector has a degree of responsibility or even stewardship obligations will not be recorded in balance sheets. This might be taken to imply that there is a case for additional reporting through other means, including management commentary and other wider reporting covered by the IPSASB's Recommended Practice Guides.

We have some sympathy with this view, but we would advise caution in addressing this by making the RPGs mandatory for information on natural resources. Regard should be had on a case by case basis for the extent to which the information contributes to the best picture of key matters in the GPFR and related reporting. More crucially, we consider that this should be considered holistically, having regard to developments in sustainability reporting.

Our comments on the preliminary views and matters for comment in the Invitation to Comment are provided in an attached annex.

I hope this is a helpful contribution to the development of standards and guidance in this area.

Chapter 1 Project Background and Scope

Preliminary View 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?

We agree that for a natural resource to be potentially recognisable as an asset, it needs to be a resource as described in the IPSASB Conceptual Framework.

CIPFA understands that the criteria 'naturally occurring' is intended to provide a demarcation between resources potentially recognised as natural resource assets and those resources that are already covered by existing IPSASs, and 'in its natural state' makes a similar distinction by considering whether naturally occurring resources have been processed in a way which transforms them into resources covered by other IPSAS.

CIPFA conditionally agrees with the IPSASB's preliminary view. We have some concerns over the operationalisation of the criterion of being in 'natural state' in standards, but if this can be done effectively, we would fully agree with Preliminary View 1.

Specific Matter for Comment 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?

We have not identified any significant issues with this for subsoil resources.

There is complexity in relation to living and water resources; for example, few forests or rivers in the world have not been subject to human intervention.

We believe that the Consultation Paper addresses and seeks to alleviate this complexity, including through its definition of 'natural state' for water in terms of the natural water cycle, but we wonder if this may cause problems in practice, or require clarification or refinement of the definition. For example, we would tend to agree that water in artificial lakes, reservoirs, canal or strengthened rivers is likely to be in its natural state, in that it remains part of the natural cycle. However, the creation of dams may affect the disposition of water elsewhere and reduce the amount of water in other water systems. The creation of canals has in some cases been carried out explicitly to improve the quality

of lake water used for drinking, and in some cases has had adverse effects on other linked water systems both in terms of quality and quantity. It does not seem intuitively appropriate that the resources which have been diminished are automatically characterised as being subject to human intervention taking them out of scope, rather than for example, being measured at a different amount.

The definition may also not be the most obvious interpretation of the phrase 'in its natural state' and there may be a need for particular care both in the framing of standards and messaging to readers of the financial statements.

Specific Matter for Comment 2

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?

There is an obvious linkage between sustainability reporting and the natural resources project, and the project represents a significant opportunity to connect financial reporting to broader reporting issues. The responsible and accountable use (and in some cases decisions not to use or intervene) in the area of 'natural resources' is a key element of the sustainability of ecosystems.

Chapter 2 Should a Natural Resource be Recognized?

Preliminary View 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.

CIPFA agrees that resources should only be recognised as assets in general purpose financial statements if they satisfy the definition of an asset, and there is no reason why natural resources should be treated different from any other asset.

Consequently, we agree with the IPSASB's preliminary view.

Chapter 3 Subsoil Resources

Preliminary View 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.

Preliminary View 4

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.

Preliminary View 5

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

Preliminary View 6

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

Preliminary View 7

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.

CIPFA agrees with the IPSASB's Preliminary Views 3 to 7.

Generally, we have not identified any public sector specificities which might necessitate different treatment to the accounting treatment applied by private sector entities under IFRS.

Chapter 4 Water

Preliminary View 8

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.**

CIPFA agrees with the IPSASB's Preliminary View 8

As we note in our response to SMC 1 there is complexity in that few rivers or lakes would have not been subject to some human intervention. We believe that the Consultation Paper addresses and seeks to alleviate this complexity, having regard to whether intervention is sufficiently minimal to avoid disrupting the 'natural state' of water in terms of the natural water cycle, but we wonder if this may cause problems in practice, or require clarification or refinement of the definition.

However, we do agree with the IPSASB views on water which is more or less likely to be 'controlled', that it may sometimes be possible to attribute meaningful value to such water, and that where this is not possible no asset should be recognised.

Chapter 5 Living Resources

Specific Matter for Comment 3

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?

CIPFA is not aware of any instances in relation to living organisms subject to human intervention where the guidance would not be sufficient to determine which IPSAS to apply and the consequent treatment.

Preliminary View 9

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.**

CIPFA agrees with the IPSASB's Preliminary View 9

Chapter 6 Presentation

Preliminary View 10

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.

CIPFA agrees that for natural resources recognised as assets an equivalent level of information should be provided as for other assets, as outlined in paras 6.7-6.13.

CIPFA also agrees that where the existence of natural resource assets is certain, but recognition is not carried out due to measurement uncertainty, the disclosures outlined in 6.14 will be useful.

CIPFA also agrees with the discussion of reporting on custodial responsibility at 6.15.

Preliminary View 11

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?

The fiscal sustainability of some governments is substantially dependent on the exploitation of natural resources, whether recognised as assets or not, and for whole of government reporting on these entities the provision of the information in line with the three IPSASB RPGs will often be highly pertinent.

Specific Matter for Comment 4

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.

CIPFA recognises that there are arguments that for some entities, information of this kind will be very important for users of GPFRs. However, we would not expect this to be true for all entities below Whole of Government Accounts level, or for all countries.

In line with this, we would not immediately support mandating the RPGs in relation to natural resources. The RPGs are not designed for application as mandatory pronouncements, and it is not clear to us that this would result in proportionate reporting in all cases, particularly in the middle ground between entities for which the information is clearly highly relevant, and those for which the information is clearly non-material or otherwise not relevant.

We suggest that it is also important to link development in this area with the wider sustainability reporting agenda, so that, for example, information on the financial potential of unused resources can be understood in the context of environmental impacts.