Response to the IPSASB Public Consultation on Exposure Draft 92, Tangible Natural Resources

We would like to congratulate IPSASB for significant advance on the development of an IPSAS on Natural Resources. We greatly appreciate the enormous hard work by the team, working group, the Board, CAG and PIC over the years. In particular, we would like to commend Edwin Ng for his efforts in bringing the standard to the Exposure Draft (ED) stage. This is a path-breaking standard as it considers, for the first time, accounting by owners of natural resources.

We note that, in addition to ED 92, an IFRS alignment component comprising of IPSAS 50, *Exploration for and Evaluation of Mineral Resources*, and *Stripping Costs in the Production Phase of a Surface Mine* (Amendments to IPSAS 12), have been approved, bringing these aspects in line with private sector accounting standards. We also note that there may be further IPSAS with intangible natural resources being an obvious category. We also note that this work would inform the broader effort on sustainability reporting.

The video introduction to ED 92, *Tangible Natural Resources* sets out why the IPSASB decided to focus on natural resources (our highlights):

> *Natural resources are prevalent in many jurisdictions and could make up a significant proportion of a country's financial position.* ***Currently there is no explicit guidance on natural resources in IPSAS or any other international accounting framework*** *so these resources are typically not reported in the general purpose financial statements. Because of this lack of reporting, the rights to natural resources are normally granted to third parties before their exploitation so governments often have little idea of their monetary value until the resources are extracted. Some constituents have noted that* ***this lack of information has led many governments to treat the sale of Natural Resources as a windfall and this could lead to mismanagement from both a fiscal or environmental sustainability perspective****. Based on these concerns,* ***the development of accounting guidance for natural resources is*** *important because it not only fills a gap in the IPSASB literature but is also* ***expected to improve public financial management and could lead to better policy decisions for many governments****. In addition to these concerns, the IPSASB also noted that the* ***accounting for natural resources would be an important input into environmental sustainability****. Thus, the development of guidance on natural resources forms part of the board's broader approach to addressing sustainability reporting.*

Who we are

In 2016, the Goa Foundation raised the issue of the lack of accounting standards for sub-soil mineral resources for Mineral Owners, usually governments. This lack led to a default treatment of receipts from alienation of such resources as windfalls. This, together with the lack of understanding of the monetary value, led to both financial and environmental unsustainability. We engaged in the 2018 IPSASB strategy consultation, and along with a number of other stakeholders, strongly supported the development of one or more IPSASs to fill the gap. We have since followed the quarterly discussions on the standards with interest.

We have also continued to develop our thinking in the area. We provide below a list of our research and advocacy documents, along with academic papers & advocacy co-authored by our Research Director, Rahul Basu. Our response is informed by this work.

1) Mitigating the Resource Curse by Improving Government Accounting (2016)
2) Government accounting and the Resource Curse – Response to FAQs (2017)
3) Letter to IMF Managing Director on the Arctic Refuge, USA (2018)
4) Letter to UN Committee of Experts on Environmental-Economic Accounting (UNCEEA) (2018)
5) Minerals as a shared inheritance: Accounting for the resource curse, published in *The Extractive Industries and Society* (preprint / published) (2020)
6) Response to IPSASB Consultation Paper on Natural Resources (2022)
7) Intergenerational Equity requires treating Mineral Sale Proceeds (MSPs) as Non-Debt Capital Receipts (NDCR) (Recommendations to India's 16th Finance Commission) (2024)
8) Ethical Accounting for Mineral Endowments - A Framework for Sustainable Public Finances, forthcoming in *The Review of Income and Wealth* (preprint / when published) (2025)

The latest paper discusses the parallel effort in the statistical community to improve the treatment of subsoil resources in the UN System of National Accounts (SNA) and the IMF Government Finance Statistics Manual (GFSM). While there are significant differences in approach between the accounting and statistical communities, notably in the insistence on the use of market values in the SNA & GFSM as well as the separation between operating income and other comprehensive income, the overall issues remain the same: how do we ensure financial and physical sustainability?

Overall comments

The SNA and GFSM are single documents that are revised periodically. The IPSAS however are comprised of many, many standards and at any point in time, a number are in revision. This makes it extremely hard for outsiders to understand exactly how IPSASB proposes sub-soil mineral resources be treated by mineral owning public sector units. For example, ED92 proposes to restrict itself to tangible natural resources held for conservation, with tangible natural resources being excluded from the definition of *Heritage Assets* in IPSAS 45, *Property, Plant and Equipment*. Further, as a residual standard, it deals only with those natural resources that do not fall within IPSAS 45, *Property, Plant and Equipment*, IPSAS 12, *Inventories*, IPSAS 16, *Investment Property* and IPSAS 27, *Agriculture*.

But what is the treatment of subsoil mineral resources when they are to be extracted and sold, often through concessionary lease arrangements, or directly by the Mineral Owner through state-owned enterprises? Does the Mineral Owner recognize a mineral asset at the time of entering into a concessionary lease? How does this connect with *Concessionary Leases and Other Arrangements Conveying Rights over Assets* (itself amending IPSAS 43, *Leases*, IPSAS 47, *Revenue*, and IPSAS 48, *Transfer Expenses*)

What is the measurement basis (IPSAS 46, *Measurement*)? If the lower of historical cost or market value is the basis, in the case of subsoil resources this amounts to exploration and evaluation costs. When the minerals are sold to the Extractor, would the difference be treated under IPSAS 47, *Revenue*? If so, then how does this address the original problem that the true value of the subsoil resources is not recognized, leading to recognition of windfall revenue, which creates perverse incentives to extract and sell mineral resources for much lower than their true worth, which is eventually unsustainable in both financial and physical terms?

Does the Mineral Owner recognize a liability on account of the concessionary mineral lease? Is this not in effect a capital transfer from the Mineral Owner to the Extractor? How is this to be treated?

Usually title to minerals is transferred at a defined delivery point, often the mine gate, and the mineral sale consideration is due at that time. The Mineral Owner often has rights to decide on the quantity produced (e.g., many oil & gas production sharing agreements) and may even have rights to preempt the minerals (e.g., mineral leases in India). What happens when the mineral is extracted under a concessionary lease but not dispatched from the mineral lease area? Does the mineral enter into the inventory of the extractor or the Mineral Owner? Does the Mineral Owner recognize revenue or a non-debt capital inflow on account of the sale of an asset?

It is impossible for someone not working full time on IPSAS to understand the answers to these questions.

Given this opaqueness, we would strongly recommend that the Board use a few examples of common situations to examine how the IPSAS would treat tangible natural resources. Examples could include:

a) Minerals are extracted and used by the Mineral Owner (e.g., construction sand used to build concrete roads)
b) Minerals are extracted by "raising contractors" and the extracted minerals are handed to the Mineral Owner to further sale (e.g., Telengana, India for construction sand)
c) Minerals are extracted under a mining lease issued by the Mineral Owner to an Extractor, which lease includes an obligation on the Extractor to "win the ore" and to pay royalties and other sums as the consideration for the minerals extracted and transferred to the Extractor. Often, these mineral leases have royalties that can be changed periodically by the Mineral Owner or national regulator, the Extractor having the right to walk away. The Mineral Owner or regulator could have rights to pre-empt the minerals (to keep pricing honest with ad-valorem royalties)
d) Mineral leases terminate due to efflux of time, which reverts the remaining subsoil minerals to the exclusive ownership of the Mineral Owner
e) Terminated mineral leases may be issued again, potentially by way of auctions (e.g., Goa between 2014 and 2022)
f) Mineral leases may be terminated as they are working in an eco-sensitive zone (e.g., some iron ore leases in Goa terminated by India's Supreme Court in 2003). These mineral leases are not reissued as the forest/sanctuary above is held for conservation.
g) Production sharing arrangements for oil & gas are subject to Investor-State Dispute Settlement (ISDS) treaty provisions, and termination of such arrangements even before extraction could result in significant sums payable by the Mineral Owner to the Extractor (e.g., Reko Diq, Baluchistan, Pakistan). The Report of the United Nations Special Rapporteur on the issue of human rights obligations relating to the enjoyment of a safe, clean, healthy and sustainable environment titled *Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights* documents claims of up to $200 billion, claims up to 167 times the investment, and awards of up to $40 billion.

Understanding the problem

The crux of the problem is that sub-soil minerals have intrinsic value, known to economists as Resource Rent (market value minus full costs of extraction including a normal profit for the extractor). This intrinsic value has little connection with the costs of exploration. This

makes it somewhat analogous to research & development expenditure[1], where the success of any individual expenditure can vary dramatically. It also makes it very unlike inventories or property, plant and equipment, where the historical cost has a reasonably direct connection with the replacement value as well as the value of the output.

When minerals are discovered, it increases the net worth of the Mineral Owner to the extent of the resource rent. Like many other inheritances, if we use lower of historical cost or market value for valuation, the resource rent is effectively treated as revenue. This creates incentives to liquidate the family silver and consume the proceeds, returning the net worth to the level before receiving the inheritance, seemingly sustainable. It is therefore more appropriate to treat mineral discoveries as increases in capital (to the extent of resource rent) without impacting revenue – dirty surplus accounting.

However, the resource rent itself can fluctuate wildly due to a variety of reasons. If the mineral asset is recognized at discovery (we note that this is not proposed in ED 92), then we can find revaluations swamp everything else in the financial statements, unless this is also handled using dirty surplus accounting.

In this scenario, the extraction and consequent sale would give rise to mineral sale proceeds, which would be treated as capital receipts. The difference between the value of the mineral and the mineral sale proceeds would be treated as a capital loss/gain.

Subsoil minerals in the ground worth the resource rent yields zero income. If extracted, sold and the mineral sale proceeds invested in the financial markets, the overall income will increase. Premature asset recognition creates strong incentives to extract and sell every last bit of minerals. While this may seem appropriate from a financial perspective, from a physical sustainability perspective, we risk accelerating our broader sustainability crisis. It would be better to recognize minerals as assets only at the point of extraction. This avoids the incentives to liquidate the minerals as well as wild fluctuations in net worth.

The 2025 paper above therefore recommends for the SNA & GFSM as follows:

1. **Avoid premature recognition of mineral assets unless necessary.** Minerals are valuable inheritances and their conservation a priority. Governments should avoid recognizing mineral assets on balance sheets before extraction takes place. Premature recognition creates perverse incentives for unsustainable resource exploitation, distorting public accounts and overstating a country's economic capacity. The data relies on many guessed assumptions and annual revisions introduce unnecessary

[1] This could potentially extend to intellectual property and intangibles generally

volatility to the national balance sheet. Recognizing mineral assets at extraction encourages more responsible management of these resources.

2. **Classify Mineral Sale Proceeds as Capital Receipts.** Governments should treat all proceeds from the sale of minerals as capital receipts, rather than revenue. This approach recognizes that mineral extraction depletes inherited wealth, and treating these proceeds as capital encourages reinvestment to maintain long-term national wealth.
3. **Record Losses from Mineral Extraction as Expenses.** Any loss in value from mineral extraction should be recorded as an expense in government accounts. This provides a more accurate picture of the economic impact of mineral extraction. Loss is the difference between the Resource Rent and the proceeds governments receive from extraction contracts. By recording and disclosing these losses, governments can present a more accurate picture of the economic impact of mineral extraction.

In addition, we recommend:

4. IPSASB adopt dirty surplus accounting for mineral discoveries, revaluation and catastrophic losses.
5. Treating minerals at the lower of historical cost or market value, as required by IPSAS 12, *Inventories*, IPSAS 16, *Investment Property* and IPSAS 45, *Property, Plant and Equipment* is over-conservative as it ignores the resource rent.
6. In situations where minerals are held in trust (e.g., the International Seabed Authority, which follows IPSAS, is only the manager of deep seabed minerals in the area beyond national jurisdiction – they are the Common Heritage of Humankind), standalone accounts for the trust are needed.

Recommended way forward

Seen in totality, we believe that the current proposal(s) do not correspond to the objectives set out – lowering the risk of mismanagement of natural resources from a financial or environmental sustainability perspective. The core issues haven't been addressed. For this reason, we are unable to support the current approach of IPSASB to natural resource accounting.

What is being attempted is path-breaking – a completely new set of international accounting standards for natural resources. The consequences of getting this wrong are quite severe. We therefore suggest that IPSASB as well as the other public and private sector standards setters engage in a [2 year] process with academia and practitioners to first scope out the problem (how do we account for mining asteroids?), then discuss and

debate various approaches in order to try and anticipate as many issues that may arise and arrive at conclusions that are likely to create the correct set of incentives for users of public sector financial statements. This could be quarterly in-person conferences where research agendas are set out, perspectives presented, further questions raised, hopefully converging towards some consensus. We appreciate that such a process has been attempted with the quarterly IPSASB meetings as well as the Academic Advisory Group. However, the engagement with a broader set of people has not taken place.

Specific responses to the ED

Specific Matter for Comment 1: Scope

We share the concern about ED92 being a residual standard. Further, just as Heritage Assets are being redefined to exclude natural resources, so too should natural resources be excluded from IPSAS 45, *Property, Plant and Equipment*, IPSAS 12, *Inventories*, and IPSAS 16, *Investment Property*. Separate standards (or modifications of the existing standards) are needed to take into account the resource rent component of value. Lower of historical cost or market value is inappropriate.

Specific Matter for Comment 2: Definitions

We share the concern that natural resources held for conservation may not provide service potential or the capability to generate economic benefits.

Specific Matter for Comment 3: Depreciation

While natural resources are usually considered non-wasting assets, degradation is certainly possible. This has happened in numerous cases historically, both due to natural and human causes. The climate uncertainty threatens a variety of natural resources (e.g., coral bleaching of the Great Barrier Reef).

Specific Matter for Comment 4: Exemption from Certain Disclosures

We support exemption from certain disclosures, especially if they are likely to be counter-productive to the overall goal of financial and physical sustainability. In the case of subsoil mineral resources, we believe premature asset recognition is likely to be counterproductive, although some level of disclosure may be warranted to ensure proper management and oversight.

We would not like to comment on the remaining SMCs as we believe that the overall package of IPSAS to deal with Natural Resources needs revisiting.