

IVSC Extractive Industries Project

The Valuation of Mineral, Oil and Gas properties

The International Valuation Standards Council (IVSC) is an independent, not-for-profit, private sector organisation that has a remit to serve the public interest. The IVSC's objective is to build confidence and public trust in the valuation process by creating a framework for the delivery of credible valuation opinions by suitably trained valuation professionals acting in an ethical manner.

The IVSC achieves this objective by:

- (a) creating and maintaining the International Valuation Standards (IVS);
- (b) issuing technical guidance for professional valuers; and
- (c) promoting the development of the valuation profession and ethical practices globally.

The IVSC Standards Board has resolved to undertake a project to review its previous guidance on the valuation of properties in the extractive industries, to consider the need for a new IVS and/or revised guidance and then to develop the necessary documents following the IVSC Due Process procedures.

This paper describes the background to the project, identifies matters that Board believes need to be addressed and identifies other standard setting bodies in the sector that may have an interest in outcome.

The IVSC wishes to form a working group to progress the project. This will ideally include individuals with different perspectives on the valuation of mineral, oil and gas properties, for example:

- expertise in preparing valuations of interests in minerals, oil and gas properties (both for production and reserves),
- experience of standard setting in the sector,
- preparers and auditors of financial statements that include valuations,
- users of valuations,
- with a regulatory or oversight interest in valuations in this sector.

Nominations for membership of the working group are invited. An application form and further details can be obtained from the IVSC Technical Director, Chris Thorne by email cthorne@ivsc.org.

IVSC Extractive Industries Project

The Valuation of Mineral, Oil and Gas properties

BACKGROUND

The extractives industries have, in recent years, attracted particular interest from securities regulators, organisations like the International Accounting Standards Board (IASB), auditors and NGO's with an interest in the sustainability of reserve developments and the benefits that flow from the extractive industries.

There is concern at the proliferation of different practices that exist for the classification and valuation of mineral resources. For example, although the United Nations Economic Commission for Europe has produced the United Nations Framework Classification for Fossil Energy and Mineral Resources Terminology (UNFC) that is referenced in the Guidance Note published by the IVSC in 2005¹, feedback received from the IASB's project in 2010² indicated that many major industry participants do not adopt this.

A number of codes for the valuation of mineral resources have been produced and three of the most commonly recognised are identified below. However, as these codes generally acknowledge, they are produced to meet the requirements of specific national jurisdictions. In the absence of a globally accepted overarching standard these codes are used outside their intended area of application but this creates problems of application for the valuer and relevance for the recipient.

The difficulties caused by a lack of a single, well recognised international valuation code has been publicly commented upon by Hong Kong Exchanges and Clearing Ltd, which is one of the leading global exchanges in the minerals sector.

Following an analysis of the responses to its discussion paper in 2010, the IASB is currently consulting on its future agenda and whether this should include a review of the way in which extractive activities are reported in financial statements. If such a project is confirmed it has been indicated to the IVSC that it could be very helpful if some globally accepted valuation standards and guidance for the sector had been developed. This would help it in its deliberations as to the extent to which fair values are a relevant and useful measure in financial statements.

EXISTING STANDARDS

The Australasian Institute of Mining and Metallurgy (AusIMM) and the Australian Institute of Geoscientists first produced the "VALMIN" Code in 1995, which has subsequently been updated in 2005. The 2005 version indicates that the code is intended to apply primarily to Technical Assessments and Valuations prepared in accordance with Australian law, circumstances, practices and terminology, although reference is made to the then emerging IVSC GN14.

In 2003, the Canadian Institute of Mining, Metallurgy and Petroleum produced the "CIMVAL" Code which consists of Standards and Guidelines for the valuation of mineral assets. This acknowledges the influence of the VALMIN Code and also indicates that the intention is that the CIMVAL Code will be adaptable to meet the "general thrust" of the IVSC's work when this is adopted internationally.

¹ GN 14 Valuation of Properties in the Extractive Industries –International Valuation Standards 2005 republished 2007. This guidance was withdrawn by the IVSC Standards Board in February 2010.

² DP/2010/1 Extractive Activities IASB April 2010

The South African Code for the Reporting of Mineral Asset Valuation (the "SAMVAL Code") was produced in 2008 by a group under the leadership of the South African Institute of Mining and Metallurgy (SAIMM). This code acknowledges that "...national Mineral Asset Valuation Codes in other countries, and from Valuation and Accounting bodies such as the International Valuation Standards (IVS) and the International Accounting Standards Board (IASB) differ from each other and this Code".

All these Codes contain prescriptive rules dealing with who may value, what should be disclosed and definitions geared to national statutory or regulatory requirements. Some of the requirements are similar to those in the IVS General Standards³ although there are some differences of language. Other requirements relate to matters that would not be relevant in an international context. They also include some rules relating to valuer conduct, which is outside the remit of IVS, although IVSC is in the process of developing a Code of Ethical Principles.⁴

The Committee for Mineral Reserves International Reporting Standards (CRIRSCO) is an organisation formed to standardise market-related reporting definitions for mineral resources and mineral reserves globally. It produced a template for the public reporting of minerals reserves that contains detailed protocols for identification, measurement and reporting. It contains little in relation to valuation save for providing that a company must disclose any relevant information concerning a mineral deposit that could materially influence the economic value of that deposit to the company.

IVSC GUIDANCE NOTE 14

The IVSC first published Guidance Note 14, *Valuation of Properties in the Extractive Industries* in 2005. This was reviewed by the IVSC Standards Board as part of its Standards Improvement Project. It was considered that this needed a thorough review that went beyond the scope of the Improvement Project. Board members were concerned although it referenced the UNFC classification and some CRIRSCO definitions it did not explain their relevance to the valuation process. It also contained some very specific definitions based on equivalents in various national codes. However these largely reflected national legislative or regulatory requirements and served little purpose in the context of valuation guidance produced for global use. Finally the Board felt that there was insufficient guidance on the valuation inputs, assumptions, approaches and methods that should be considered in mineral valuation, which should be the overriding purpose of valuation guidance.

The Board therefore voted to withdraw GN14 in February 2010, pending the outcome of a comprehensive project to review the nature and scope of standards and guidance required to bring about convergence of valuation practice in the sector.

The International Valuation Standards (IVS) contain a Framework and General Standards that form the foundation of all standards and guidance developed for specific asset classes. There was therefore a need to focus resources on the completion of the Standards Improvement Project. With the revised standards having been approved by the Board in March 2011 and due to be published in July 2011 the Board can now turn its attention to other projects.

³ IVS 101 Scope of Work, IVS 102 Implementation and IVS 103 Reporting issued July 2011

⁴ Proposed Code of Ethical Principles for Professional; Values – Second Exposure Draft June 2011

THE IVSC PROJECT

It is anticipated that valuations in the sector will be found to present some unique challenges when compared with other asset classes. These will include, but be not limited to:

- uncertainty over quantities available for extraction;
- uncertainty of prices for extracted commodity;
- uncertainty of costs involved in exploration and recovery;
- mineral resources normally have a life that is limited by economic, contractual or physical considerations;
- that ownership of the rights to the mineral, to the surface and the rights to extract may be held separately;
- the impact of government regulation and taxation on the sector;
- the costs of decommissioning and restoration.

Valuations of mineral producing or fossil fuel properties and reserves are carried out for a variety of reasons including:

- mergers and acquisitions
- pricing initial public offerings of stock,
- listing support,
- for use in financial statements following business combinations or in impairment reviews,
- the grant or acquisition of rights,
- tax computations and
- as components of corporate valuations and fairness opinions.

Although there was significant agreement by respondents to the suggestion in the IASB's 2010 Discussion Paper that fair value was probably not an appropriate measurement basis for mineral, oil or gas properties, there are many other reasons why the development of globally recognised valuation standards and guidance will assist valuers, investors and regulators and help in building investor confidence.

The overall brief of the project is to:

1. Consider the need for and, if appropriate, develop an Asset Standard for mineral oil and gas properties.

An IVS Asset Standard consists of a standard and a commentary. The standard sets out requirements that either modify or augment the IVS General Standards and include illustrations of how the principles in the General Standards are generally applied to the particular asset class. The commentary provides additional background information on the characteristics of each asset type that influence value and identifies common valuation inputs, approaches and methods.

2. Consider the need for and develop any associated guidance to support the standard and publish as a Technical Information Paper (TIP).

An IVSC TIP provides authoritative but non-mandatory guidance designed to be of assistance to valuation professionals and informed users of valuations alike. It can examine methods identified in a Standard in greater depth and illustrate their application. A TIP guides rather than instructs. It does this by providing information that is helpful to practitioners in exercising the judgements they are required to make during the valuation process, but should avoid anything that would restrict the proper exercise of that judgement by the imposition of inappropriate rules. A TIP should not direct or require the use of a particular method in specific circumstances but can include discussion of factors that should be considered when deciding which method it is appropriate to use. A TIP should also focus on practical issues rather than underlying theory and as such is not intended to provide comprehensive training or be an educational document.

It is suggested that the first stage of the project should involve the Working Group considering the following:

- The need to create a standard supplementary to the current IVS to reflect the particular challenges of valuation in the sector and whether there is consensus on acceptable valuation assumptions and input data verification procedures for different valuation purposes.
- An examination of existing national codes such as VALMIN, CIMVAL and SAMVAL to identify matters that may usefully be carried forward into either a future IVS Standard or TIP.
- Identifying common valuation methods used in the sector, developing guidance on those methods and matters that need to be considered in their application.
- Identifying any known valuation practices that are considered inappropriate.
- Developing a skeleton of a possible new IVS Standard and a possible new TIP for referral to the IVSC Standards Board.

The first task of the Working Group will be to review this proposed scope and make any recommendations for significant changes considered appropriate to the Board.

Ends