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# Powerful players: how constituents captured the setting of IFRS 6, an accounting standard for the extractive industries

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# Powerful players: how constituents captured the setting of IFRS 6, an accounting standard for the extractive industries


## Abstract

This paper illustrates the influence of powerful players in the setting of IFRS 6, a new International Financial Reporting Standard (IFRS) for the extractive industries. A critical investigative inquiry of the international accounting standard setting process, using Critical Discourse Analysis (CDA), reveals some of the key players, analyses the surrounding discourse and its implications, and assesses the outcomes. An analysis of small cross-section of comment letters submitted to the International Accounting Standards Committee (IASC) by one international accounting firm, one global mining corporation and one industry group reveal the hidden coalitions between powerful players. These coalitions indicate that the regulatory process of setting IFRS 6 has been captured by powerful extractive industries constituents so that it merely codifies existing industry practice.



**Key words:** international accounting standard setting, Critical Discourse Analysis, extractive industries, regulatory capture, IFRS.

# 1. Introduction

The extractive industries are a powerful force in global political and economic relations. With this sector including oil, gas, and mining companies such as Exxon Mobil, BHP Billiton, Anglo American, and the Royal Dutch/Shell Group, the extractive industries are significant at both national and international levels. In 2005, the world's top twenty extractive industries companies recorded profits in excess of US$211 trillion (Fortune Magazine, 2006). Comparing this to the United States' 2005 Gross Domestic Product of US$11 trillion gives some idea of the enormity of this sector. When investigating an industry of this stature, it is appropriate to scrutinise the reporting practices adopted by entities to disclose financial information. As such, the accounting standards which guide the preparation of financial reports must also be considered. The most recent efforts to regulate extractive industry accounting were proposed by the International Accounting Standards Committee (IASC), now the International Accounting Standards Board (IASB).[1] In 1998 when the IASC initiated the extractive industries project, its aim was to address the divergent accounting practices used by companies operating in the sector. By 2004 when the IASB finally released IFRS 6, *Exploration for and Evaluation of Mineral Resources*, the standard did little to regularise varied accounting practice and instead codified existing industry practice enabling companies to continue reporting in their preferred mode.

To make sense what was essentially inaction by the IASB, the publically available discourse put forward during the process of setting the extractive industries standard

[1] The IASC was restructured from the International Accounting Standards Board (IASB), which became operational in 2001. Throughout this paper both bodies will be referred to since the Extractive Industries project was initiated by the IASC and carried forward by the IASB.

was analysed using Critical Discourse Analysis (CDA). The outcome, IFRS 6, is framed in terms of regulatory capture to suggest that the IASB was captured by the very constituents it was supposed to regulate. This paper presents some of that analysis, focussing on a cross section of key players: Exxon Mobil, a major extractive industries company, PricewaterhouseCoopers (PwC), the audit firm for Exxon Mobil, and the American Petroleum Institute, a lobby group for the oil and gas industry of which Exxon Mobil is a member.

The paper is organised as follows. The background details relating to extractive industries accounting and the methods of accounting for pre-production activities is first presented. This is followed by a description of the methodological approach based on regulatory capture theory and facilitated by CDA. Empirical analysis of publically available discourse provides evidence of the lobbying efforts of the key players, and conclusions are drawn on the basis of understanding the outcome of the international accounting standard setting process for the extractive industries as an example of regulatory capture.

## 2. Background

Many companies engaged in the extractive industries are high profile, economically important, and have operations that span the globe. A diversity of approaches to accounting for and reporting the results of extractive operations has evolved in the world’s major mining regions of Australia, Canada, South Africa, the United Kingdom (UK), and the United States (US). As the extractive industries continued to become increasingly important globally, the IASC recognised that there was a need for an international accounting standard that would provide investors and other users with relevant, reliable, and comparable financial information (International Accounting Standards Committee, 2000; International Accounting Standards Board, 2004).

In response to this perceived need, in 1998 the IASC added to its agenda an extractive industries project aimed at identifying and addressing the measurement and disclosure issues faced by the extractive industries. Among the many issues under consideration, a particular concern related to the methods used to account for pre-production costs by extractive industries entities. Pre-production costs are those incurred as a result of activities undertaken to explore the existence of mineral reserves and evaluate their commercial viability. These pre-production costs, also referred to as exploration and evaluation costs, can run into the hundreds of millions of dollars, and for some smaller exploration companies can be a substantial drain on resources in the search for oil or minerals. Over time, two main methods of accounting for pre-production costs have developed: the successful efforts method and the full cost method (Pratt, 1990; International Accounting Standards Committee, 2000; Bryant, 2003).[2]

The important difference between these methods is the amount of pre-production cost capitalised under each method. Under successful efforts accounting, pre-production costs can only remain capitalised if they relate to the successful discovery and development of a mineral reserve (Flory and Grossman, 1978; International Accounting Standards Committee, 2000). In the pre-production stage, all costs may be capitalised but if an exploration project proves to be unsuccessful, these costs must be written off. If the project is successful, then the capitalised costs are amortised

[2] Variations of these two main methods have developed over time, however it is these two methods that are the focus of this research.

against the revenue earned from the project (Flory and Grossman, 1978; Amernic, 1979; Frazier and Ingersoll, 1986; International Accounting Standards Committee, 2000). The successful efforts method is arguably consistent with accounting principles of matching and conservatism, however the inherent uncertainty associated with exploration activities means that the income streams and asset balances of entities reporting under the successful efforts method can fluctuate significantly (Editorial, 1986; Frazier and Ingersoll, 1986). While this does not present much of a problem for large enterprises that can afford to absorb losses from unsuccessful ventures, it can be a significant issue for smaller companies and they have tended to avoid successful efforts accounting (Editorial, 1986; Frazier and Ingersoll, 1986).

In contrast, the full cost method is much more popular with smaller exploration companies. Under full cost accounting, all pre-production costs regardless of whether they relate to a successful or unsuccessful project may be capitalised as an asset (Flory and Grossman, 1978; Amernic, 1979; Frazier and Ingersoll, 1986; International Accounting Standards Committee, 2000). The pre-production costs are carried forward indefinitely and then matched against revenue derived from successful ventures. Because there is no requirement to expense unsuccessful projects under the full cost method, an income smoothing effect results (Flory and Grossman, 1978; Ingersoll, 1986; International Accounting Standards Committee, 2000). For smaller companies with limited sources of finance, strict debt covenants, and aggressive exploration programs, the full cost method represents an opportunity to expand and develop (Flory and Grossman, 1978; Amernic, 1979; Frazier and Ingersoll, 1986; Ingersoll, 1986; Johnson and Ramanan, 1988; Van Riper, 1994; Jeter, 2001).

The impact of each of these methods on reported profits can be substantial. For example, Premier Oil, an oil producer based in the United Kingdom, restated its profits in 2004 in preparation for the transition to IFRS (Neveling, 2005). Reporting under the full cost method, the company posted a $44 million profit. However, after switching to the successful efforts method, the result was a downward restatement of profits to $22 million (Neveling, 2005). It was this type of reporting disparity that prompted the IASC to address these reporting practices at an international level when it embarked on its extractive industries project in 1998 (International Accounting Standards Committee, 2000; 2000; Wise and Spear, 2000; Micallef, 2001; Rabee, 2003). However, this is not the first time standard setters have sought to address the successful efforts versus full cost accounting issue.

The controversy over successful efforts versus full cost accounting first erupted in the 1970s and centred pre-dominantly in the US. In response to the 1973 world oil crisis, the US government enacted the *Energy Policy and Conservation Act* in 1975, which stipulated that standardised accounting practices for the extractive industries be established (Katz, 1985; Cortese *et al.*, 2008). In 1997, the US Financial Accounting Standards Board (FASB) in charge of the standardisation proposed that the successful efforts method be mandated as the single method of accounting for oil and gas pre-production costs (Flory and Grossman, 1978; Van Riper, 1994; Cortese *et al.*, 2008). In the deliberations that followed, proponents of the full cost method argued vigorously for the retention of both the full cost and successful methods, stressing the importance of the full cost method to the continuation and growth of US oil and gas exploration companies (Van Riper, 1994). The Ad Hoc Committee on Full Costing was formed by industry constituents, congressional leaders were targeted by companies and lobby groups, and many on the receiving end commented that they had "never seen such aggressive lobbying in their Washington careers" (Gorton, 1991, p.30 cited in Van Riper, 1994, p.64). The eventual outcome of all this was a win to the lobbyists. The FASB proposals were rejected by the Securities and Exchange Commission and instead a standard was issued that required extensive disclosures about oil and gas producing activities without actually mandating a particular method for disclosure (Katz, 1985; Van Riper, 1994).[3]

A multitude of investigations into accounting for the extractive industries emerged following the FASB's proposal to eliminate the full cost method of accounting for pre-production activities and require entities to report under the successful efforts method. Numerous studies have examined, for example, the market effects of the proposed change in accounting method (Baker, 1976; Amernic, 1979; Collins and Dent, 1979; Dyckman, 1979; Dyckman and Smith, 1979; Lawrie, 1986). Other studies have investigated the relationship between accounting method choice (full cost or successful efforts) and company characteristics such as size, age, exploration aggressiveness, exploration success, demand for capital, and debt to equity ratio (Deakin, 1979; Lilien and Pastena, 1981). Other strands of research on the topic have attempted to predict reasons for switching between accounting methods (Johnson and Ramanan, 1988; Nichols, 1993), and have studied the relationship between successful efforts and full cost data and company share price (Bandyopadhyay, 1994; Berry *et al.*, 2003; Bryant, 2003; Al Jabr and Spear, 2004).

[3] For a more detailed discussion of the history of the successful efforts versus full cost controversy see (Cortese *et al.*, 2008).

Given that attempts to standardise accounting methods were unsuccessful in the US in the 1970s and that the IASB has also been unable to implement uniformity, there is a need to understand why this is the case rather than simply analysing the market effects of the different methods. To redress this imbalance in the literature, this paper applies a critical investigative lens to the international accounting standard setting process. It examines the due process of the IASC/IASB, the key players contributing to it, and evaluates the outcome, IFRS 6. It seeks to uncover the political connections and powerful coalitions that influence the process and shape its outcomes. Because this project is industry-specific, it provides a unique opportunity to study constituents that have common social, political, and economic interests. Critical Discourse Analysis provides a method to explore the standard setting process. Regulatory capture theory provides a lens through which to understand and interpret it.

## 3. Methodological approach: regulatory capture and CDA

CDA positions the international accounting standard setting process in its social, political, and economic contexts and reveals the relationship between the IASC/IASB and extractive industries constituents. Central to CDA is the understanding that language (written or spoken) is integral to social life and fundamental to political negotiations at a number of levels. Fairclough (1993, 1995, 2003) identified three levels that must be considered in critical analyses of discourse:

> (e)ach discursive event has three dimensions or facets: it is a spoken or written language *text*, it is an instance of *discourse practice* involving the production and interpretation of text, and it is a piece of *social practice* (emphasis in original) (Fairclough, 1993, p.136).

Thus, each discursive event is comprised of three levels, while a simultaneous relationship exists between each level. It is the identification of linkages between these three levels that enables the relationship between "discourse, power, dominance and social inequality" (Van Dijk, 1993, p.249) to be discerned and illuminated (Fairclough, 2003). By examining the text, or public discourse and the social structure within which the text is put forward (social practice), it is possible to expose the discourse practice as an "interactive process of meaning-making" (Fairclough, 2003, p.10) that occurs as public discourse is produced, received, and interpreted.

As part of the standard setting process, the Extractive Industries Issues Paper (hereafter the Issues Paper) was published in November 2000, and comments were invited from interested parties concerning the issues raised (International Accounting Standards Committee, 2000). In response, comment letters were received from a variety of constituents including mining and petroleum companies, extractive industries lobby groups, and international accounting firms. At face value, these responses appeared fairly innocuous. However, by examining these responses and respondents through a critical investigative lens, in the vein of Sikka and colleagues (Sikka *et al.*, 1989; Sikka, 1992; Mitchell and Sikka, 1993; see for example Mitchell *et al.*, 1994; Sikka and Willmott, 1995; Mitchell *et al.*, 1998; 2001), a number of overlapping interests among the respondents themselves, and between the respondents and the IASC/IASB, were revealed. It became evident that there was potential for powerful players to influence the international accounting standard setting process. CDA was used to examine these publicly available responses. CDA explicitly positions this discourse in the context of the social practices and institutional arrangements of the IASC/IASB. The international accounting standard setting process is viewed as an “interactive process of meaning making” (Fairclough, 2003, p.10) through which discourse is used to exert “power, dominance, and social inequality” (Van Dijk, 1993, p.249). In other words, CDA provides a framework through which to study documents, websites, and other archival data, and seek connections between these data. It facilitates understanding of a particular process or event rather than just looking for information for its own sake. By providing a framework that specifically searches for connecting relationships between key players in the standard setting process, the potential for regulatory capture to be exposed is far greater than if, for example, a content analysis based method of reviewing comment letters was used.

To facilitate an understanding of the standard setting process following analysis of discourse, regulatory capture theory is adopted as a theoretical lens. Regulatory capture explains the predisposition of regulated industries, such as the extractive industries, to capture the regulatory body, in this case the IASC/IASB (Mitnick, 1980; Walker, 1987). Regulatory capture theory was derived from economic theories of regulation, which sought to explain the pattern of regulation by governments (Posner, 1974). Developed by “an odd mixture of welfare state liberals, muckrakers, Marxists, and free market economists”, regulatory capture theory was used to argue that regulation was supplied in response to the demands of particular interest groups (Posner, 1974, ,p.335). Mitnick’s (1980) conception of regulatory capture focused specifically on the relationship between regulatory bodies and the industries they were intended to regulate. It considered how aspects of this relationship can promote capture and result in the regulatory body making decisions and taking actions consistent with the preferences of the regulated industry (Mitnick, 1980).

Very few accounting studies have examined accounting regulation from this perspective. A notable exception is a study by Walker (1987), a former member of the Accounting Standards Review Board (ARSB) in Australia, who provided a personal account of the Australian accounting standard setting process.[4] Walker (1987) used Mitnick's (1980) theory of regulatory capture to argue that the accounting standard setting process in Australia had been captured by the interest groups it was established to regulate. In developing his argument, Walker (1987) traced the early history of the ASRB and noted the lobbying power of the accountancy bodies in the early stages of the ASRB's formation, which ensured that the ASRB would not have independent research capabilities. He also argued that the profession had "managed to influence the procedures, priorities, and output of the Board", and further, that it had influenced appointments to the Board so that "virtually all members of the Board might reasonably be expected to have some community of interests with the profession" (Walker, 1987, p.282). Having provided a convincing argument for the regulatory capture of the ASRB, Walker (1987) concluded by stressing the importance of highlighting the process of accounting standard setting and examining the political arrangements surrounding the process.

Walker's (1987) account was an insider's view of regulatory capture taking place. Not being privy to the inner workings of the IASC/IASB, this inquiry provides a bird's eye view of the extractive industries project. The development of the project is traced from its placement on the IASC agenda, to the formation of the Steering Committee, to the development of the Issues Paper, the calling for responses, the

[4] The Accounting Standards Review Board was replaced by the Australian Accounting Standards Board (AASB) in 1991.

resulting comment letters, and the eventual production of the accounting standard. A summary of how CDA and regulatory capture are used to understand the standard setting process is presented in Figure 1.

(Take in Figure 1)

As shown in Figure 1, the first stage of CDA involves collating the public discourse. In other words, this stage involves finding out who is having a say in the standard setting process and determining what they are saying. In this analysis, the comment letters submitted in response to the Issues Paper comprise the public discourse. Comment letters were received by 52 respondents, many of them powerful extractive industries companies, lobby groups, and international accounting firms. Within the context of the IASC/IASB's due process, this public discourse is put forward by interested parties in order to influence a favourable outcome. This context forms the social practice element of CDA portrayed in Figure 1.

The social practice element of CDA provides a context within which to view the public discourse. The international accounting standard process takes place within the context of the IASC/IASB's established due process procedures and funding arrangements and outcomes are influenced by them. Further, that this particular standard, IFRS 6, is an industry specific standard, the presence and influence of the extractive industries must also be considered part of the institutional framework. By interpreting the public discourse in the context of social practice structures, connections can be made, forming the discourse practice element of CDA.

At the discourse practice level, it is important that public discourse and social practice be considered concurrently so that connections can be uncovered and explored. To do this, the relationships between extractive industries constituents and the IASC/IASB are examined closely to reveal linkages which might influence the outcome of the standard setting process. Thus, discourse practice makes connections between the public discourse and the social practice to show how meanings are created and controlled. CDA thereby enables this discourse practice to be exposed and analysed, rather than remaining hidden and taken-for-granted. As noted, from a wider examination of the discourse practice surrounding the standard setting process, a case study is presented that examines the linkages between Exxon Mobil, PwC, the API, and the IASC/IASB.

## 4. Social practice: The IASC/IASB

Significant in understanding the context in which international accounting standard setting operates is a consideration of the IASC/IASB's funding arrangements and dur process. Prior to the IASC's restructure in 2001, its revenue came from three main sources: fees paid by Board members and by the International Federation of Accountants, profits made on IASC publications, and voluntary contributions from companies and other organisations with an interest in the work of the IASC (International Accounting Standards Committee, 1999). The major international accounting firms have been providing monetary support to the IASC since the external funding initiative was launched in 1990 and have always been its major source of funding (International Accounting Standards Committee, 1993). As part of the restructure, the IASC Foundation was formed as a not-for-profit entity, and it was envisaged that the IASB would be supported primarily by private contributions of chartered accounting firms and business enterprises internationally (International Accounting Standards Committee Foundation, 2001).

Brown (2006, p.86) noted the irony of the not-for-profit status of the IASC Foundation when it is, in fact, closely tied to "big business" through its funding scheme. He argued that the IASC/IASB's funding arrangements set up a dependency relationship between the IASC/IASB and its benefactors which may result in the marginalisation of critical issues, such as environmental and social accounting, in favour of issues that align with the political and economic interests of the supporters (Brown and Shardlow, 2005; Brown, 2006). With the IASC Foundation receiving contributions totalling over US$16,000,000 from 283 corporations, associations, and other institutions, including a number of the world's leading multinational corporations in 2006 (International Accounting Standards Committee Foundation, 2003), the ability of the IASC/IASB to "unlock itself from the patronage and dependency of its large funders" is indeed questionable (Brown, 2006, p.88). Table 1 shows a list of all respondents to the Issues Paper and indicates which of these respondents also provides financial support to the IASC/IASB.[5]

(Take in Table 1)

The institutional arrangements that support the setting of international financial reporting standards also involve a "due process" (International Accounting Standards Committee, 1993). During this consultative stage, the views of "experts from the accounting profession, users of financial statements, business community, and national standard setting bodies" are sought (International Accounting Standards

[5] An excerpt from the IASB's 2006 annual report, which lists its financial supporters for that year, is presented in Appendix 1.

Committee, 1993, p.1).[6] To lead the due process for the extractive industries project, the IASC established a Steering Committee, which was claimed to be internationally representative. Consistent with the composition of the IASB itself, and other Boards and Committees of the IASB (Brown, 2004), the Steering Committee members were drawn almost exclusively from international accounting firms, and large multinational corporations from Australia, the United Kingdom, the US, and Canada. There was no representation from other extractive industries stakeholder groups such as developing countries, environmental groups, and human resources groups (International Accounting Standards Committee, 2000; Brown, 2006).

The Steering Committee led the development of the Extractive Industries Issues Paper, published in November 2000. The Issues Paper was a 412-page document consisting of 16 chapters which raised a number of "Basic Issues" and "Sub-Issues" concerning matters such as reserve estimation and valuation, recognition and measurement of inventories, and financial statement disclosures. To guide commentators, the Issues Paper also set out the Steering Committee's "tentative views" on some of the issues considered most significant (International Accounting Standards Committee, 2000). Interested parties were invited to comment on their preferred method for accounting for pre-production costs. The Steering Committee's tentative view indicated its preference for the successful efforts method of accounting for pre-production activities and suggested that only one method should be permitted in the IFRS for the extractive industries. Therefore, in effect, the Steering Committee

[6] A critique of the social discourse of this "due process", while worthy of further study, is beyond the scope of this paper. Mouck (2004) explores the subjective social construction of a financial reporting regulatory framework, which he described as the "rules of the game".

was attempting to eliminate the use of the full cost method and require all extractive industries enterprises to report under the successful efforts method. .

The comment letters submitted to the IASC/IASB comprise the public discourse and focal point for the critical analysis of the international accounting standard setting process. Although the IASC distributed the Issues Paper to almost 300 companies worldwide, only 52 comment letters were received. These were from respondents in Australia, Canada, China, Germany, South Africa, the United Kingdom, and the US. The respondents included mining companies, petroleum companies, extractive industries lobby groups, international accounting firms, professional accounting bodies, standard setting bodies, and academics.

Over seventy percent of respondents to the Issues Paper commented on the successful efforts versus full cost issue, with the vast majority supporting elimination of the full cost method of accounting for pre-production costs. However, a closer analysis of respondents supporting the elimination of full cost accounting showed that the majority of proponents were large extractive industries enterprises that were already using the successful efforts method of accounting or international accounting firms, which have these same large enterprises as clients. The respondents arguing against the cessation of the full cost method were smaller exploration companies and lobby groups that represented the interests of these smaller companies as well as large extractive industries enterprises. Thus, these lobby groups, most notably the American Petroleum Institute and the UK Oil Industry Accounting Committee, represent a powerful coalition of extractive industries entities.

Having situated the public discourse (comment letters) within the social context of the international accounting standard setting process for the extractive industries, the discourse practice must be considered to determine how the discourse was produced by respondents (that is, by whom the discourse was created and what it contained), and how it was received, and interpreted by the IASC/IASB. Given the large volume of comment letters available for analysis, to illustrate the connections among respondents, and between the respondents and the IASC/IASB, as noted, a small cross section of respondents was selected: Exxon Mobil Corporation, PwC, and the API. In the following sections, the overlapping interests of these extractive industries players are revealed to gain a richer understanding of the discourse practice that contributed to the standard setting process.

## 5. Public Discourse: The Key Players

### *5.1 PricewaterhouseCoopers*

PwC is the largest of the “Big 4” international accounting firms, providing auditing and assurance, crisis management, human resource management, tax, and advisory services to its clients. Recording gross revenues of US$20.3 billion in 2005, PwC’s client list includes 84% of the companies in the Fortune Global 500 index (PricewaterhouseCoopers, 2005). One of these clients is the Exxon Mobil Group, for which PwC is the external auditor.

PwC provided two responses in respect of the Issues Paper, one from its South African branch and another from its Australian office. In response to the full cost versus successful efforts issue, PwC Australia supported the tentative views of the Steering Committee, indicating that it would prefer a method consistent with the successful efforts method and that only one method should be allowed. However, PwC Australia also cautioned the IASC against using “established terms” such as full cost and successful efforts because of the variety of different meanings and hybrid approaches that have evolved. They stated that “their continued use may only serve to perpetuate existing differences in thinking and practical application” (PricewaterhouseCoopers South Africa, 2001). While PwC South Africa supported the views of the Steering Committee, it noted that “special consideration” should be given to junior companies, allowing them to carry forward costs pending determination of commercially recoverable reserves (PricewaterhouseCoopers South Africa, 2001).

These Big 4 accounting firms have traditionally provided important resources to the IASC/IASB in the form of finance (see Table 1), personnel, technical expertise, and members for many of the IASC/IASB’s committees. Indeed PwC was represented on the Steering Committee established to direct the extractive industries project and formulate and publish the Issues Paper. As well as providing direct support, these international accounting firms serve an important liaison function between the IASC/IASB and their clients. Evidence of the interaction between chartered firms and their clients with respect to IASC/IASB issues can be found in the opening paragraphs of the comment letter submitted by PwC South Africa, in which the firm stated that “in preparing this response we have sought input from members of our South African firm” (PricewaterhouseCoopers South Africa, 2001, p.1). In addition, Georgiou (2004) provided evidence that a considerable number of companies lobby the IASB through their external auditor thus requiring extensive consultation between auditor and client in order to ensure that client interests are accurately represented. An important client of PwC is the Exxon Mobil Corporation.

## *5.2 The Exxon Mobil Corporation*

The Exxon Mobil Corporation is a US-based petroleum and petrochemical company, with operations that span more than 200 countries across 6 continents. The company is involved in exploration, production, refining, and marketing of oil, gas, and petrochemical products (Exxon Mobil Corporation, 2005). Exxon Mobil's most recent financial highlights include total revenue of US$298 billion, net income of US$25.3 billion, total assets of US$195 billion, and a market valuation of US$300 billion (Exxon Mobil Corporation, 2005). In 2004, Exxon Mobil's financial statement were audited by PwC, which received US$47.5 million from the company for the provision of audit, advisory, and taxation services (ExxonMobil Corporation, 2005). The auditor/client relationship of PwC and Exxon Mobil, the personnel and financial connections between IASC/IASB and PwC, and the financial donations made to the IASC/IASB by Exxon Mobil and its subsidiary Esso Imperial Oil, create a complex web of interconnectedness between these players.

The Exxon Mobil Group submitted two almost identical comment letters: one from Exxon Mobil Corporation itself, and one from its Canadian subsidiary, Esso Imperial Oil. Both comment letters indicated support for the successful efforts method, not surprising given that both entities reported under the successful efforts method and have adequate resources to absorb losses that may be incurred from unsuccessful exploration efforts (Esso Imperial Oil, 2004; ExxonMobil Corporation, 2005). However, also stressed in both comment letters was overriding preference for US

Financial Accounting Standard 19 (FAS 19). An excerpt from Esso's comment letter follows:

> "In general our responses to the IASC issues are based on the view that U.S. Financial Accounting Standard (SFAS) No. 19 should be the definitive accounting standard for oil and gas company accounting and disclosures" (Esso Imperial Oil, 2001).

Interestingly, this US accounting standard was the key driver of the successful efforts versus full cost controversy during the 1970s. FAS 19 proposed to prohibit the use of the full cost method and required all US oil and gas companies to use the successful efforts method to account for pre-production costs. This was the same standard that was eventually rejected by the Securities and Exchange Commission, but it was amended in FAS 25 to allow companies to use either the full cost or successful efforts methods for reporting purposes (Financial Accounting Standards Board, 2005). So, although ostensibly agreeing with the IASC's proposal, the most acceptable outcome for this powerful extractive industries group would be an approach consistent with US GAAP, which allows substantially more flexibility than that proposed in the Issues Paper.

As indicated above and shown in Table 1, the Exxon Mobil Group has a direct financial relationship with the IASB. The Group has been a "supporter" of the IASB since 2001, providing an annual but undisclosed sum of money to help fund the activities of the IASB. Exxon Mobil and its subsidiary companies are also affiliated with a number of industry bodies including the International Association of Oil and Gas Producers, the API, the US National Petroleum Council, the US Energy Association, the UK Petroleum Industry Association, the Australian Institute of Petroleum, and the Canadian Association of Petroleum Producers. Of these industry lobby groups, the API submitted a comment letter in response to the Issues Paper on behalf of its members.

### *5.3 The American Petroleum Institute*

The API, a North American-based industry lobby group, represents over 400 members involved in all aspects of the oil and gas industry (American Petroleum Institute, 2005). Both Exxon Mobil and Esso Imperial Oil are members of the API. The mission of the API is to "influence public policy in support of a strong, viable U.S. oil and natural gas industry" (American Petroleum Institute, 2005). To that end, the API engages in legislative and regulatory advocacy and provides a forum within which members can collaborate to develop consensus on policy matters such as those contained in the IASC's Issues Paper (American Petroleum Institute, 2005).

Many of the API member companies have provided financial assistance to the IASC/IASB as either underwriters or supporters and/or also responded to the Issues Paper, including BP, the BHP Billiton, ConocoPhillips, Exxon Mobil, Kerr-McGee, the Royal Dutch/Shell Group, and Total. While the API's representation of such large multinational corporations is important, individually, these entities already have a voice: they have the resources, inclination, and ability to participate in policy making decisions, such as the setting of an international accounting standard for the extractive industries. The value of the API, and coalitions like it, is that it is able to present these individual views in a collective and unified manner and also to provide an opportunity for smaller entities to have their interests represented on issues from which they would otherwise be excluded. While the API's full member list is not publicly available, of the 250 members that are listed, the vast majority are junior exploration companies or relatively small industry service providers that are unlikely to possess the expertise or resources to participate in high level accounting standard setting policy deliberations. Further, by allowing their views to be represented by an industry coalition such as the API, individual extractive industries companies may avoid making controversial public statements about the IASC/IASB's proposals, while still being able indirectly to participate and influence the setting of the accounting standard.

The API, in its comment letter, indicated its support for policies and practices consistent with US GAAP, and specifically for the provisions of FAS 19 which, as discussed, provide significantly more accounting flexibility than the proposed international accounting standard (American Petroleum Institute, 2001). The API stressed the importance of providing the industry the "flexibility" of both the full cost and successful efforts approaches to accounting and allowing entities to choose the method most suitable for financial reporting:

> The U.S. oil and gas industry has accounted for its operations in accordance with Financial Accounting Statement (FAS) 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies* for almost 25 years. [FAS 19] has provided the flexibility to account for the petroleum industry under either a successful efforts concept or a full cost concept. We support the practice of allowing an enterprise to choose among the successful efforts and full cost accounting models in the primary financial statements (American Petroleum Institute, 2001, p.2).

The API acknowledged the controversial nature of this position but argued that comparability of results between successful efforts and full cost entities had not proved to be a problem for the US because of disclosure requirements that allowed users to differentiate between the two methods (American Petroleum Institute, 2001). The API's position on this issue is consistent with the history of US controversy over the full cost versus successful efforts methods of accounting. Given the outcomes of the IASC/IASB's extractive industries project, discussed in the next section, it appears that an industry lobby group is an effective vehicle for participation and influence over international standard setting processes.

## 5. IFRS 6: a "new" standard for the extractive industries?

The Steering Committee's tentative view on the full cost versus successful efforts issue was that only the successful efforts accounting method should be available for use by extractive industries entities. In other words, the IASC was attempting to eliminate the use of the full cost method of accounting for extractive activities and require entities to report under the successful efforts method. PwC agreed with the broad position of the Steering Committee although, as already noted, its South African branch suggested that special consideration should be given to junior entities. Exxon Mobil, and its subsidiary Esso Imperial Oil, of which PwC was the auditor, also endorsed the views of the Steering Committee. However, it indicated an over-riding preference for an approach consistent with FAS 19, which offered considerably more flexibility than that proposed in the Issues Paper. The API directly opposed the views of the Steering Committee, arguing that preserving existing practices and allowing companies the flexibility of both the successful efforts and full cost methods was important to the extractive industries.

The Steering Committee intended to review the public responses to the Issues Paper and, on the basis of these, develop an Exposure Draft which would also be published for public comment (International Accounting Standards Committee, 2000). The comments received in respect of the Exposure Draft would be reviewed, after which a final standard would be produced for consideration by the restructured IASC Board. However, at the time the Issues Paper was published, the IASC was in the midst of restructuring. As a consequence, the IASC's plans for the development of the extractive industries project came with the caveat that "the restructured IASC Board will have to decide its own agenda and priorities" (International Accounting Standards Committee, 2000, p.5). Indeed it did.

In July 2001, the IASB announced that it would restart the project only when agenda time permitted (International Accounting Standards Committee Foundation, 2003; 2004). Then in September 2002, it was decided that it was not feasible to complete a comprehensive project in time for adoption by entities in 2005. Instead, on 15 January 2004, *Exposure Draft 6 Exploration for and Evaluation of Mineral Resources* (ED 6) was issued in lieu of a comprehensive international accounting standard for the extractive industries (International Accounting Standards Committee Foundation, 2004).

The exposure draft intended to make limited improvements to accounting practices for exploration and evaluation expenditures without requiring major changes that may need to be revised once a comprehensive review of the accounting practices of extractive industries entities was made (Heaphy, 2004; International Accounting Standards Committee Foundation, 2004). In other words, ED 6 proposed that entities be permitted to continue with their most recent accounting policies, which could be the full cost or successful efforts method, until the completion of a comprehensive review. Unsurprisingly, there was little opposition to these proposals and the provisions of ED 6 were eventually incorporated into IFRS 6, issued on 9 December 2004 (International Accounting Standards Board, 2004). It appears that the time frame for continued use of existing accounting policies is unspecified at this stage, with no comprehensive review initiated or development of the extractive industries project since IFRS 6 was issued (International Accounting Standards Board, 2005).

Viewing this outcome through the lens of regulatory capture theory, it appears that the extractive industries have captured the international accounting standard setting processes in order to secure favourable regulation from the IASB. The focus here has been on the overt, publicly visible behaviour of the players, but it is probable that covert lobbying has also been vehement. The contribution of lobbying activity to the development of a relationship between the extractive industries and the IASC/IASB is unquestionable. Extractive industries companies and industry groups have been active and vigorous lobbyists of the IASC/IASB since the early stages of the international accounting standard setting project, contributing to over 60 percent of the comment letters in respect of this matter and representing the views of hundreds of economically and politically powerful companies. In terms of financial support, the IASC/IASB was shown to benefit substantially from the resources provided to it by the companies discussed in this paper, in addition to many other extractive industries benefactors not covered here. Furthermore, the extractive industries contributed to the development of the Issues Paper and IFRS itself through representation on the Extractive Industries Steering Committee.

The “new” international accounting standard, IFRS 6, is in effect reinforcing the status quo and simply codifying established industry practice. Choice in methods of accounting is retained, along with a substantial degree of reporting flexibility to the preparers of financial reports. While this situation may be desirable for the preparers of the reports, the extractive industries companies, it is contrary to the espoused objectives of accounting standards, whose aim is to facilitate the creation of financial reports that provide guidance to users when making economic decisions (McBride and Carroll, 2005, p.12).

## 6. Conclusions

Adopting a critical investigative approach, this research has exposed the connections and overlapping interests which were implicated in the process of setting the IFRS for the extractive industries. Using CDA, the social and institutional contexts within which the process occurs revealed that the IASC/IASB funding arrangements and due process contribute significantly to the influence of powerful industry players. An analysis of the public discourse arising as a result of the due process revealed not only what was said in the responses to the Issues Paper, but, more importantly, who it was said by and the significance of these respondents in light of their relationship with each other, and with the IASC/IASB itself.

The discourse practice element of CDA facilitated this analysis of the relationships between players involved in the international accounting standard setting process, which was then explained in terms of regulatory capture theory. An examination of the discourse practice, using PwC, Exxon Mobil, and the API, exposed the “interactive process of meaning-making” that occurred during the standard setting process. The due process procedures were not the objective, transparent, and representative measures they are claimed to be. Rather, the due process provided a forum within which powerful and self-interested constituents and constituent coalitions could contribute to and capture the standard setting process in order to secure favourable regulation. For many constituents, such as the Exxon Mobil Corporation and PwC and members of the API, the potential to influence the development of the IFRS may have been seen as a return on their investment in the IASC/IASB. The web of overlaps between players arguably resulted in the outcome of the international accounting standard setting process: an interim IFRS that codified established, and largely unregulated, industry practices.

The focus of this study has been on the IASB, on the development of one accounting standard, on the publicly available responses made to one Issues Paper, and on a cross-section only of those responses. The authors believe, however, that the coalitions exposed by CDA, and explained using regulatory capture theory, indicate the possibility of fruitful further study. This could be achieved by widening the focus to other extractive industries players, to the public discourse surrounding other issues relating to accounting for the extractive industries, to accounting standard setting issues in general, or to other accounting matters where there is a visible public discourse within an institutional setting. While the attention of this paper has been on the issue of whether the full cost or successful efforts method should be used to account for pre-production costs, there are other issues relating to the extractive industries, for example, accounting for removal and restoration costs, which have not received the same public airing. Further research could also use interviews as a means of adding depth and more of an “insider’s” perspective to the findings.

The IASC/IASB's international accounting standard setting process, while rhetorically open and transparent, has the potential to be co-opted by powerful interest groups. While it is widely acknowledged that the accounting standard setting process is political, this research has provided details of the source, nature and effect of this politicisation within the development of an international accounting standard for the extractive industries.

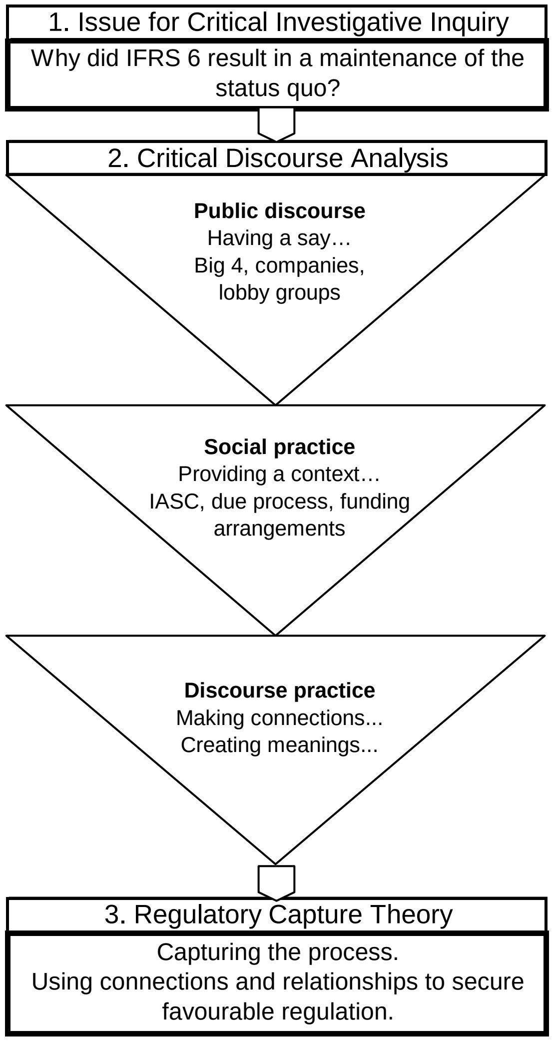


**Figure 1. Applying Critical Discourse Analysis and Regulatory Capture to international standard setting for the extractive industries**

**Table 1: Respondents to the Issues Paper**

| Company name and principal activity | Location | Funding to IASC/IASB |
|---|---|---|
| ***Mining companies*** | | |
| Anglo American Platinum Corporation Limited | South Africa | Yes |
| Anglo American plc | UK | Yes |
| Anglo Gold Limited | South Africa | Yes |
| Balfour Holding Inc | USA | No |
| BHP Billiton | Australia | Yes |
| Gold Fields Limited | South Africa | Yes |
| Goldfields Limited | Australia | Yes |
| Normandy Mining Limited | Australia | No |
| Rio Tinto | UK | Yes |
| Sasol Mining Limited | South Africa | No |
| ***Mining Industry Lobby Groups**** | | |
| Australian Gold Council | Australia | No |
| Australiasian Joint Ore Reserves Committee | Australia | No |
| Minerals Council of Australia | Australia | No |
| South African Chamber of Mines | South Africa | No |
| Group of 100 | Australia | No |
| ***Petroleum companies*** | | |
| Conoco Inc | USA | Yes |
| Ente Nazionale Idrocarburi (ENI) | Italy | Yes |
| Enterprise Oil plc | UK | No |
| Esso Imperial Oil | Canada | Yes |
| Exxon Mobil Corporation | USA | Yes |
| John S Herold Inc | USA | No |
| Kerr-McGee North Sea Limited | UK | No |
| Melrose Resources plc | UK | No |
| Paladin Resources plc | UK | No |
| PetroChina Company Limited | China | Yes |
| RWE - DEA AG | Germany | Yes |
| RWE AG | Germany | Yes |
| RWE Rheinbraun AG | Germany | Yes |
| Woodside Petroleum Limited | Australia | No |
| ***Petroleum Industry Lobby Groups**** | | |
| American Petroleum Institute | USA | No |
| Oil Industry Accounting Association | UK | No |
| ***Big 4*** | | |
| Deloitte Touche Tohmatsu International | International | Yes |
| KPMG | International | Yes |
| PricewaterhouseCoopers | Australia | Yes |
| PricewaterhouseCoopers | South Africa | Yes |
| ***Professional accounting and standard setting organisations*** | | |
| Association of Chartered Certified Accountants | UK | No |
| Canadian Institute of Chartered Accountants | Canada | No |
| FACPCE | Argentina | No |
| Fédération des Experts Comptables Européens | Europe | No |
| Föreningen Auktoriserade Revisorer | Sweden | No |
| Institut der Wirtschaftsprüfer | Germany | No |
| Institute of Chartered Accountants in Australia | Australia | No |
| Institute of Chartered Accountants in England and Wales | UK | No |
| Institute of Chartered Accountants of Pakistan | Pakistan | No |
| Institute of Chartered Accountants of Zimbabwe | Zimbabwe | No |
| Japanese Institute of Certified Public Accountants | Japan | No |
| South African Institute of Chartered Accountants | South Africa | No |
| International Valuations Standards Committee | UK | No |
| ***Others*** | | |
| Dr Geoff Frost/Ms Martine Hardy | Australia | No |
| Professor Terry Heazlewood | Australia | No |
| Kenneth Arne | Kazakstan | No |

* While there is no information to indicate that these industry lobby groups provided direct financial support to the IASC/IASB, individual members were benefactors of the IASC/IASB making these coalitions important sources of financial support.

## Appendix 1: IASB Financial Supporters for 2006[1]

**ACCOUNTING FIRMS ($1,500,000 p.a.)**
Deloitte Touche Tohmatsu
Ernst & Young
KPMG
PricewaterhouseCoopers

**CORPORATE & OTHER PRIVATE SECTOR SUPPORTERS**
ABN Amro
Accor[2]
Aegon Group N.V.
Air France- KLM
Air Liquide
Air Water Inc.
Aisin Seiki Co., Ltd.
Alcatel
Allianz AG[3]
Alps Electric Co., Ltd.
Alstom
Altana AG
American International Group, Inc.
Arcelor
Asahi Breweries, Ltd.
AstraZeneca PLC
AXA
Azsa & Co.
Banco Bradesco S/A
Banco Itaú S/A
Bank of America Corporation
Banque de la Réunion
BASF AG
Bayer AG
Bayerische Motorenwerke AG
BDO International N.V.
Bear Stearns & Co
BNP Paribas
Boeing Company
Bouygues
BP plc
BT
Bull
Calbee Foods Co., Ltd.
Canon Inc.
Canon Marketing Japan Inc.
Cap Gemini Ernst & Young
Capital Research and Management
Carrefour
Casio Computer Co., Ltd.
Cemex S.A. de C.V.
Central Japan Railway Company
Cesar
Ciments Français
Citigroup, Inc.
Citizen Watch Co., Ltd.
CNP Assurances
Commerzbank AG
Companhia Vale do Rio Doce (CVRD)
Crédit Agricole SA
DaimlerChrysler
Denso Corporation
Dentsu Inc.
Deutsche Bank AG
Deutsche Bundesbank
Deutsche Post
Deutsche Telekom AG
Dexia
Dresdner Bank AG
E.ON AG
EADS
EDF SA
Euler Hermes
Euronext N.V.
Familymart Co., Ltd.
Fimalac
Fitch Ratings
Fortis SA-NV
France Telecom
Fuji Television Network, Incorporated
Fuji Xerox Co., Ltd.
Fujitsu Limited
Gaz de France
General Electric Company
GlaxoSmithKline
Goldman Sachs Group, Inc.
Grant Thornton
Groupe Danone
Grupo Santander
Hamamatsu Photonics K.K.
Hankyu Corporation
Hanwa Co., Ltd.
Haseko Corporation
Heineken
Henkel KGaA
Hirose Electric Co., Ltd.
Hitachi Cable, Ltd.
Hitachi Capital Corporation
Hitachi High-Technologies Corporation
Hitachi Maxell, Ltd.
Hitachi Medical Corporation
Hitachi Metals, Ltd.
Hitachi Software Engineering Co., Ltd.
Hitachi Transport System, Ltd.
Hitachi, Ltd.
Hong Kong Exchanges & Clearing Ltd.
HypoVereinsbank AG
Imerys
Infosys
ING Group N.V.
Inpex Holdings Inc.
Ishikawajima-Harima Heavy Industries Co., Ltd.
Itochu Corporation
Itochu Enex Co., Ltd.
Itochu Techno-Solutions Corporation
J.P. Morgan Chase & Co.
Japan Telecom Co., Ltd.
JC Decaux SA
JGC Corporation
JS Group Corporation
Jtekt Corporation
Kaga Electronics Co., Ltd.
Kajima Corporation
Kanto Auto Works, Ltd.
Kao Corporation
Katokichi Co., Ltd.
Kawasaki Kisen Kaisha,Ltd.
Keihan Electric Railway Co., Ltd.
Kintetsu Corporation
Komatsu Ltd.
Kumagai Gumi Co., Ltd.
KYB Corporation
Lafarge
Lagardere
Lehman Brothers Inc.
London Stock Exchange plc
L'Oreal
LVMH
M6 – Metropole Television
Marubeni Corporation
Matsushita Electric Industrial Co., Ltd.
Mazars
Mazda Motor Corporation
Meiji Seika Kaisha, Ltd.
Meitec Corporation
Merrill Lynch
Michelin
Microsoft Corporation
Misuzu Audit Corporation
Mitsubishi Corporation
Mitsubishi Electric Corporation
Mitsubishi Heavy Industries, Ltd.
Mitsui & Co., Ltd.
Mitsui O.S.K. Lines, Ltd.
Mitsui Sugar Co., Ltd.
Moody's Foundation
Morgan Stanley
Münchener Rückversicherungs-Gesellschaft
Nankai Electric Railway Co., Ltd.
NASDAQ Stock Market, Inc.
Natexis Banques Populaires
NEC Corporation
Nestlé SA
New York Stock Exchange
Nexans
Nichias Corporation
Nippon Oil Corporation
Nippon Paint Co., Ltd.
Nippon Paper Group, Inc.
Nippon Paper Industries Co., Ltd.
Nippon Shokubai Co., Ltd
Nippon Steel Corporation
Nippon Telegraph & Telephone Corp
Nippon Yusen Kaisha
Nisshin Seifun Group Inc.
Nitto Denko Corporation
Obayashi Corporation
Oji Paper Co., Ltd.
Oki Electric Industry Co., Ltd.
Opera Construction
ORIX Corporation
Orpar
Osaka Securities Exchange Co., Ltd.
Pernod Ricard
Petroleo Brasileiro S.A.
Pfizer
Pioneer Corporation
PPR
Prudential Financial, Inc.
PSA Peugeot Citroën
Publicis Groupe SA
Renault
Renesas Technology Corp.
Rengo Co., Ltd.
Rio Tinto London Ltd
Royal Bank of Canada
Royal DSM
Rubis
RWE AG
Safran
Saint-Gobain
Sanki Engineering Co., Ltd.
Sanlam Ltd.
Sanofi-Aventis
SAP AG
Schneider Electric
Seiko Corporation
Seiko Epson Corporation
Sharp Corporation
Shell International
Shimizu Corporation
Shin Nihon & Co.
Siemens AG
Société Générale
Sony Corporation
Standard & Poor's
State Farm Insurance Companies
Suez
Sumitomo Bakelite Co., Ltd.
Sumitomo Chemical Company, Ltd
Sumitomo Corporation
Sumitomo Electric Industries, Ltd.
Swiss Reinsurance Company
Taisei Corporation
Taiyo Nippon Sanso Corporation
Teijin Limited
Telefonica S/A
Telekomunikacja Polska S.A.
The Furukawa Electric Co., Ltd.
Thales
TIAA-CREF
Tohmatsu & Co.
Tokai Rubber Industries, Ltd.
Tokuyama Corporation
Tokyo Stock Exchange, Inc.
Toppan Printing Co., Ltd
Toyota Boshoku Corporation
Toyota Industries Corporation
Toyota Motor Corporation
Toyota Tsusho Corporation
UBS AG
Ushio Inc.
Valeo
Vallourec
Veolia Environnement
Vinci
Vivendi Universal
Vneshtorgbank
Vodafone Group Services Limited
Wendel Investissement
Yazaki Corporation
Yodogawa Steel Works,Ltd.

**ASSOCIATIONS**
Associazione Bancaria Italiana (ABI)[6]
CFA Institute
Emittenti Titoli S.p.A.[7]
Financial Executives International
General Insurance Association of Japan
Japan Securities Dealers Association
Japanese Institute of Certified Public Accountants
Life Insurance Association of Japan
Security Analysts Association of Japan
Tokyo Bankers Association
Trust Companies Association of Japan

**CENTRAL BANKS, GOVT ENTITIES & OTHER ORGS**
Accounting Standards Review Board (New Zealand)
Banca d'Italia[4]
Banco de Mexico
Bank for International Settlements
Bank Negara Malaysia
Bank of Canada
Bank of Greece
Bank of Japan
Bank of Korea
Board of Governors of the Federal Reserve System (US)
Central Bank of Ireland
Central Bank of the Russian Federation
European Central Bank
Financial Reporting Council of Australia[5]
Hong Kong Monetary Authority
International Bank for Reconstruction & Development (The World Bank)
International Monetary Fund
Monetary Authority of Singapore
Ministry of Finance, People's Republic of China
National Bank of Hungary
National Bank of Slovakia
Office of the Superintendent of Financial Institutions of Canada[4]
Reserve Bank of Australia
Reserve Bank of India
South African Reserve Bank
Swiss National Bank

1 Total of 283 financial supporters, including 124 Japanese donors paying through the Japanese Council for Better Corporate Citizenship, of which six organisations are not listed because they
2 All contributions from French companies and associations were channeled through Association pour la participation des enterprises françaises à l'harmonisation comptable internationale (ACTEO).
3 All contributions from German companies and associations were channeled through the Deutsches Rechnungslegungs Standards Committee (DRSC) e.V.
4 Its 2006 contribution arrived after the IASC Foundation's 2006 Financial Statements were closed.
5 The Australian Financial Reporting Council made its contribution on behalf of private and public sector stakeholders in the Australia accounting standard-setters
6 Contribution made on behalf of the Italian banking community.
7 Contribution made on behalf of the Italian business community.

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