July 30, 2010

International Accounting Standards Board
Extractive Activities
1st Floor, 30 Cannon Street
London, United Kingdom
EC4M 6XH

Re: Discussion Paper DP/2010/1 – Extractive Activities

We are writing in response to your request for comments on Discussion Paper DP/2010/1 – Extractive Activities[1].

With C$4.4 billion in assets under management, Northwest & Ethical Investments L.P.'s approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will provide higher risk-adjusted returns over the long term. Through our company evaluations, our active engagement with the companies in our funds, and our emerging issues research, we have developed considerable insight into good practices and weaknesses in corporate ESG disclosure, which we endeavour to share in the context of consultations on policy and standards. As a Canadian investment institution we pay particular attention to extractive industry, because it makes a major contribution to the total market capitalization of the TSX Composite Index[2], and because it is associated with significant risks from an ESG perspective.

Northwest & Ethical Investments L.P. supports the development of specific disclosure standards for extractive industry, and encourages the International Accounting Standards Board (IASB) to include work on an International Financial Reporting Standard (IFRS) for extractive activities in its agenda. This work is timely, as a growing number of investment institutions are seeking to integrate material ESG factors into their decision making. According to research by the Canadian Social Investment Organization, assets managed under socially responsible investment mandates in Canada reached over C$609 billion in 2008, representing almost 20% of total assets under management[3]. Internationally, 538 institutions managing assets in excess of US$18 trillion have become signatories to the UN Principles for Responsible Investment[4], while the Carbon Disclosure Project is supported by 534 institutions with assets under management of US$64 trillion[5]. To be able to integrate ESG considerations, investors need access to consistent data, allowing them to compare the systems and performance of companies across sectors. Disclosure and reporting standards play an important role in establishing this consistency.

Response to questions in the Discussion Paper

Our responses to the questions posed in the Discussion Paper are set out below.

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[1] http://www.iasb.org/NR/rdonlyres/735F0CFC-2F50-43D3-B5A1-0D62EB5DDB99/0/DPExtractiveActivitiesApr10.pdf.
[2] The Energy sector constitutes 27% of Canada's TSX Composite Index; the Materials sector makes up a further 20%.
[3] http://www.socialinvestment.ca/documents/caReview2008.pdf.
[4] http://www.unpri.org/files/PRI%20Annual%20Report%2009.pdf.
[5] https://www.cdproject.net/en-US/WhatWeDo/Pages/overview.aspx.

Telephone 604 633 0615 **Toll Free** 1 877 384 4225 **Fax** 604 683 2538
500 – 1111 West Georgia Street, Vancouver, BC V6E 4T6

Question 1 – Scope of extractive activities

We agree with restricting the scope of the proposed standard to upstream extractive activities. From an investor perspective there is a greater need for disclosure guidance in this area, because of the greater variation in the ESG risk profile of upstream activities within the same industry, compared to midstream and downstream activities.

Question 2 – Approach

At this juncture we do not object to the idea of a single standard covering the mining industry and the oil and gas industry, as long as necessary distinctions in disclosure requirements for each sector are recognized within that single standard.

Question 3 – Definitions of minerals and oil and gas reserves and resources

We agree with the project team's choice of definitions. In the oil and gas context, we note that the reserves and resources definitions in the Canadian Securities Administrators' (CSA) standard National Instrument 51-101[6] are closely aligned with the Petroleum Resource Management System. In our experience of evaluating both Canadian and US oil and gas sector issuers, the CSA definitions appear to generate more useful and comprehensive disclosure to investors than those used by the Securities and Exchange Commission (SEC).

Question 4 – Minerals or oil and gas asset recognition model - recognition

We have no additional comment.

Question 5 – Minerals or oil and gas asset recognition model—unit of account selection

We have no additional comment.

Question 6 – Minerals or oil and gas asset measurement model

We have no additional comment.

Question 7 – Testing exploration properties for impairment

We have no additional comment.

Question 8 – Disclosure objectives

We believe the proposed disclosure objectives are appropriate. We agree with the project team that "it is not the intention of financial reporting to meet all of the information needs of users, nor would it be possible" (point 5.15). While other stakeholders may also make use of them, the primary purpose of financial reports is to provide material information to providers of capital. Some stakeholders may be better served with different types of reporting governed by other standards and specifically targeted at their information needs.

[6] National Instrument 51-101 *Standards of disclosure for oil and gas activities* is currently under revision: see http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20091218_51-101_rfc-pro-amd.pdf

Question 9 – Types of disclosure that would meet the disclosure objectives

For the purposes of responsible investors, current company reporting often fails to provide an adequate account of material ESG issues. We offer below a number of suggestions for additional types of disclosure that could contribute to a more holistic account of the risks and opportunities facing an extractives company – focusing in particular on the oil and gas industry, and on unconventional assets.

Point 5.28

We share the view that the SEC rule restricting disclosure to proved reserves has been unhelpful to investors. If companies are not encouraged to disclose reserves and resources at different levels of commercial viability to which they hold the rights, their long-term exposure to risk can be obscured. For example, we recently evaluated a company that was following the SEC reserves disclosure rules: on paper it had no oil sands reserves, yet we know it to have a major oil sands project in production, with plans for expansion.

Point 5.30

We strongly agree with the project team that disclosure of probable and possible reserves and resources is useful, allowing the investor to develop a more sophisticated analysis of the company's long-term exposure to different risks. If the information is correctly disaggregated, there will be little risk of confusion among the audience for whom this information is of most interest.

Points 5.42 and 5.43

In Canada and internationally, the oil and gas industry is undergoing a fundamental transformation. Today's oil and gas industry looks very different from that of 20 years ago, and 10 years from now the industry will be different again from that of today. Increasingly, conventional oil and gas production is giving way to exploitation of unconventional assets. Oil sands, shale gas, coal-bed methane, offshore oil and enhanced oil recovery activities make up a significant and growing proportion of production and reserves. These unconventional assets bring a suite of benefits, costs and risks that differ from those associated with conventional oil and gas. As a result, investors require greater clarity both on the extent to which a company's strategic positioning depends on specific types of unconventional assets, and on the unique risks associated with those assets. In our experience, while some companies are showing leadership in recognizing the changing expectations of investors and acknowledging the specific risks and opportunities of unconventional oil and gas, not all issuers have been so responsive in meeting these new disclosure needs.

In this context, we believe the proposed disaggregation of reserve quantities by commodity type to oil, gas and oil sands is not adequate to allow us to analyze the ESG risks.

Disaggregation for oil sands is certainly useful. Over the past several years we have been conducting comparative research into ESG disclosure among companies operating in the Alberta oil sands, most recently publishing highlights of our research in the report *Lines in the Sands: Oil Sands Sector Benchmarking* (http://www.ethicalfunds.com/SiteCollectionDocuments/docs/lines_in_the_sands_full.pdf). We found that many of the companies we examined were failing to provide information on what we believe to be material ESG issues with potential to affect investment decision-making. For companies that were not reporting according to CSA standards, it was challenging to establish the extent of their present and likely future exposure to oil sands. However, disaggregation to the level of oil sands in general is not sufficient. Within the oil sands industry the risks that apply to mining differ from those that apply to in situ production.

Although they may produce the same end products (bitumen and synthetic crude oil), oil sands in situ and mining extraction operations warrant disaggregated disclosure because of significant differences in the technology, skills, and equipment required, and in the associated environmental challenges and impacts. Although in situ production has its own set of environmental challenges, much of the public controversy about current and potential impacts of the oil sands industry revolves around aspects that are specific to mining, such as the creation of tailings ponds.

The project team singled out oil sands for disaggregation on the basis that these are high cost operations. Following this logic, consideration should also be given to disaggregating other forms of high-cost and high-risk oil and gas production. Cost estimates for ultra-deepwater offshore oil production are in a similar range to those for oil sands. The associated ESG risks are also high, but quite different from those associated with oil sands. The BP Macondo well oil spill in the Gulf of Mexico has had devastating consequences, both in terms of environmental and social impact, and in terms of destruction of shareholder value. In the wake of the BP disaster, many more investors may now wish to have information on a company's exposure to offshore oil, especially in deepwater and ultra-deepwater environments.

The aggregation of all gas assets also threatens to obscure risk. Unconventional gas assets form a growing percentage of production. In our experience, each unconventional gas play (shale gas, coal-bed methane, etc) has unique characteristics that impact both cost and ESG risks. For example, the risks associated with hydraulic fracturing in unconventional gas production have been attracting increasing attention from both the public and investors.

Given these concerns, we would prefer to see disclosure disaggregated by oil and gas product type, as required under CSA National Instrument 51-101[7]. In fact, from an ESG perspective, the CSA instrument does not go far enough in its disaggregation requirements. In a recent submission on revision of NI 51-101 we suggested CSA should expand the product types list to distinguish oil sands bitumen and synthetic crude oil produced by different extraction methods (https://www.ethicalfunds.com/SiteCollectionDocuments/docs/csa_standards_of_disclosure_for_oil_and_gas_activities.pdf).

In sum, we feel that in an era of increasing diversity within oil and gas production, the proposed level of disaggregation in disclosure of reserves quantities is insufficient to allow investors to examine and analyze the associated ESG risks. Disclosure requirements should be guided by the statement at point 3.45: "Risk is important to users in analyzing an entity and therefore it is particularly important to report on, and account for separately, assets with significantly different risks".

Points 5.45 and 5.46

The proposal that reserve quantities should be broken down by country or project (where material) is welcome, but may not be sufficient to provide clarity on risks and opportunities.

In some cases disaggregation to country level will be enough. However, a number of countries that are significant in the resource extraction context are federal states. We note that in some federal countries, including Canada, effective jurisdiction over resources lies primarily with the provincial governments rather than the federal state, with the result that political and regulatory risk may vary from province to province. In these cases, disaggregation of data only to the country level could be misleading. The emphasis should be on the principle of disaggregation to the level of jurisdiction that is material in different political contexts, rather than to a specified level of jurisdiction.

[7] The product types for which CSA requires disclosure include: light and medium crude oil, heavy oil, natural gas, natural gas liquids, synthetic oil, bitumen, coal bed methane, hydrates, shale oil and shale gas. See http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20091218_51-101_rfc-pro-amd.pdf.

Furthermore, the Discussion Paper suggests that disclosure could be aggregated to a level above country level when reserve quantities are not material at the country level. However, country risk is not always directly proportional to the size of a specific extractive operation, nor to its relative importance for the company. Any exposure at all to certain high risk countries, such as military dictatorships, can create binary reputational risk that bears no relation to the materiality of the reserve quantity. It is fair to say that even one drop of oil or one ounce of gold from certain high risk countries can have a "contaminating" reputational effect that damages company value on a global scale.

Beyond geography, disaggregated disclosure at the geological level may be relevant in certain contexts. For example, because of differences in geological formations, some shale gas resource plays are more exposed to operational water risk than others. Depending on the geology of the resource and the location and availability of water sources, shale gas operators may face challenges including unusually heavy water requirements to support hydraulic fracturing, increased amounts of produced water for treatment or disposal, or local water scarcity creating a need to truck water to the site.

Finally, in order to assess risks and impacts effectively, property-by-property disclosure is relevant for mines, but also for oil sands operations, and possibly for deepwater oil operations. Our research for the *Lines in the Sands* report indicates that individual oil sands projects can vary greatly in their risk profiles, depending on factors such as the depth of the reservoir, the extraction method, the amount of steam used, the type and source of water used, and the relationship with local Aboriginal peoples. On the other hand, gas and conventional oil operations tend to be so dispersed geographically that property-by-property reporting is unlikely to provide added value for investors.

To sum up, it may be appropriate to break down reserves quantity data by political jurisdiction, resource play, or project, depending on the characteristics of an extractives operation and its location. Given the complexities outlined above, any disclosure requirement should be accompanied by guidance on considerations for applying different methods of disaggregation.

Other types of information that should be disclosed

The Discussion Paper seeks additional input to ensure that the types of disclosure required will respond comprehensively to the disclosure objectives. As investors integrating consideration of ESG risks we believe improved disclosure on costs, specifically for environmental liabilities and carbon pricing, is essential for sound financial decision-making.

From our experience of conducting company evaluations, we note that traditional mining companies' disclosure on environmental liabilities tends to be more extensive in comparison with that of oil and gas companies. In Canada, recognizing that the reclamation obligation is an inevitable consequence of exploitation of a resource, abandonment and reclamation costs are included in the list of costs oil and gas companies are required to forecast against future revenues. However, our research into current disclosure among companies operating oil sands mines suggests these issuers may not be providing a complete picture on reclamation and abandonment costs. Under current technology, oil sands mines create a unique reclamation obligation within the oil industry in the form of tailings ponds. Given the unresolved technical challenges surrounding final reclamation of oil sands tailings, and the large scale of the tailings legacy, the costs are likely to be significant.

Companies operating oil sands mines point to various factors to justify what appear to be low estimates of reclamation costs in their public disclosure. These include the distant horizon for reclamation of such long-lived assets, and the fact that recycled water from the tailings ponds forms part of the operational water balance (allowing the ponds to be considered as essential infrastructure, rather than liabilities). But if the purpose of disclosure is to allow investors to understand the reserves status and future net revenues from an oil sands mine, it seems misleading to downplay an unavoidable future cost that is potentially significant, even if it may not materialize in the short term. Indeed, if there is a real risk that the costs to reclaim the ponds might exceed the revenues generated, arguably these resources should not be considered as economically-viable reserves.

In fact, oil sands mine operators now face the prospect of having to take at least some action on tailings ponds in the near term. The Alberta government's new tailings directive specifies requirements on tailings reduction and reclamation progress, and will begin to apply to operations as early as June 2011[8]. This implies that tailings reclamation costs are not merely a distant prospect, but that significant actual costs will be generated well within the forecasting timeframe commonly used for public disclosures. The Alberta regulator has indicated that this is the first of several directives focused on driving forward tailings management performance, with the eventual goal of eliminating the tailings ponds.

As a material issue already addressed to a large extent by the traditional mining industry, we would encourage the IASB to include requirements for disclosure of environmental liabilities for relevant oil and gas companies in its exposure draft.

We would also urge the IASB to include guidance on, and require the disclosure of, carbon costing. Currently, the costs oil and gas companies must consider against revenue include royalties and income tax expenses – but not the cost of carbon. Carbon costs will surely be increasingly material to the calculation of future net revenues. Oil and gas producers already recognize that they are likely to be exposed to impacts from current and future regulations relating to climate change. Moreover, carbon pricing is no longer a theoretical concept as it already applies in several jurisdictions, including the Province of Alberta, site of Canada's main oil sands deposits. Although Canadian federal and global carbon pricing frameworks remain uncertain, it seems likely that carbon costs will increase and be applied more widely in future. Prudent companies should be incorporating a price for carbon into their reserves estimates, but currently there is no disclosure on how future carbon prices could impact net revenues from reserves. Oil and gas companies, along with other carbon-intensive issuers, should therefore be asked to disclose current and potential carbon costs to investors.

<u>Question 10 – Publish What You Pay disclosure proposals</u>

As a supporting investor to the Extractives Industry Transparency Initiative[9], we support the Publish What You Pay campaign and agree that relevant disclosure requirements should be incorporated into any IFRS for extractive activities.

The concerns about current disclosure identified in point 6.7 - that it is voluntary, not standardized, and not audited or traceable to financial statements - are valid. They need to be addressed for the benefit of communities, companies and investors. In countries where extractive activities are providing little benefit to public accounts, whether because of a generous royalty regime or because of corruption, companies run the risk of future tax or royalty increases, and diminishing community support for extractive projects. Standardized reporting of Publish What You Pay information would allow investors to compare payments made to governments in different countries, and to conduct proper assessment of these risks. We believe Publish What You Pay reporting is justified on cost-benefit grounds, but also note that under the terms of the new financial reform act, disclosure of extractive industry transparency information will become a requirement for extractives companies registered in the United States.

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[8] http://www.ercb.ca/docs/documents/directives/directive074.pdf

[9] http://eiti.org/supporters/investors

Conclusion

We commend the IASB for addressing disclosure on extractive activities through the Discussion Paper, and believe this project would be a worthwhile addition to its standards agenda at a time when investors are taking increasing interest in ESG considerations. Robust disclosure equips investors with the information necessary for prudent decision making. In this context, we suggest that disclosure requirements could be enhanced by:

- disaggregated disclosure of different categories of reserves and resources;
- disaggregation of reserve quantities according to product type and production method, political jurisdiction, geological formation and/or individual property (where material);
- inclusion of disclosure of environmental liabilities and carbon costing; and
- inclusion of disclosure of Publish What You Pay information.

Should you have any questions with regard to this submission, please do not hesitate to contact us.

Sincerely,
Northwest & Ethical Investments L.P.

Robert Walker,
Vice President, Sustainability