



REPORT

KPMG's Oil & Gas IFRS Survey Report

June 2010

ENERGY & NATURAL RESOURCES

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KPMG's Oil & Gas IFRS Survey Report

I am pleased to provide you with the results of our Oil & Gas IFRS Survey. We have compiled the responses from over 70 participating companies. Of the responding companies, 80 percent were publicly traded entities and 20 percent were private. I am excited to share these results with you, as I am sure that they will provide you with some candid information to help you make some critical policy choices as you work to complete your IFRS conversion project.

KPMG is right in the middle of helping many of our clients through their conversion efforts—whether it is a 5-minute phone call or a full conversion project, we are eager to be of assistance. Please do not hesitate to call me or any of KPMG's Oil & Gas partners or managers.

Finally, I would like to thank all of you who took the time to respond and support the survey. I trust you will find the results informative and useful.

Michael McKerracher
National Energy Leader
KPMG LLP



Are you applying the IFRS 1 deemed cost (full cost) exemption for Oil & Gas?



For the respondents that indicated "Yes," 79 percent mentioned they are using reserve value to allocate historical costs when using the IFRS 1 full cost exemption. Sixteen percent indicated they are using reserve volume.

A response of only 73 percent in the "Yes" category is surprising. Perhaps the "No" and "Undecided" respondents are planning on moving towards reporting in US GAAP.

In terms of the follow-up question regarding the intended use of reserve values or volumes to allocate the full cost pool, only 17 percent are planning to use volumes. There would be a greater chance of having an impairment when using volumes. We have also seen a number of companies using discount rates of 8, 10, and 12 percent when attributing reserve values.

Do you expect to take the optional IFRS 1 exemption for all business combinations prior to the transition date?



The results of this question are surprising. While 86 percent is certainly a large majority, we were expecting a number closer to 100 percent. We believe that not taking this exception could mean restating your complete history of acquisitions with the risk that some previous property purchases are captured under business combinations. The combined response of 14 percent for the "No" and "Undecided" categories is likely to be new start-up companies.

Do you expect to early adopt the new Canadian business combinations standards in 2010 to avoid differences between existing Canadian GAAP and IFRS in 2010?



While the split between "Yes" and "No" responses is nearly three to one, it will be interesting to watch what happens as companies move into Q2 and we see more acquisitions. While adoption of the standard may seem like an easy decision on first inspection, we believe many respondents have since realized that it can result in added expenses (acquisition costs) to their income statement. For those who do not early adopt, it will be another adjustment to record expenses and add additional disclosures in their 2010 comparatives.

Do you expect to take the optional exemption to reduce any Cumulative Translation Adjustment (CTA) balance to zero at the transition date?



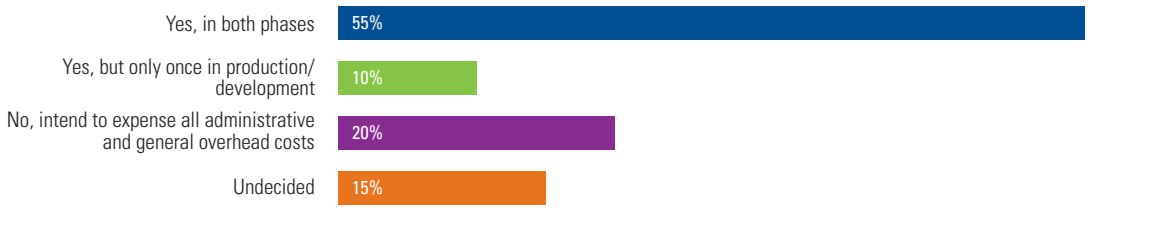
These results are not entirely surprising, but we offer two comments: first, one could expect to see the “No” and “Undecided” respondents move to the “Yes” category once they realize the amount of work that is required to restate all CTA, and, second, the respondents of this survey (primarily junior and intermediate companies) do not typically hold foreign subsidiaries.

At what point in time do you plan to capitalize costs under Exploration and Evaluation (E&E) costs?



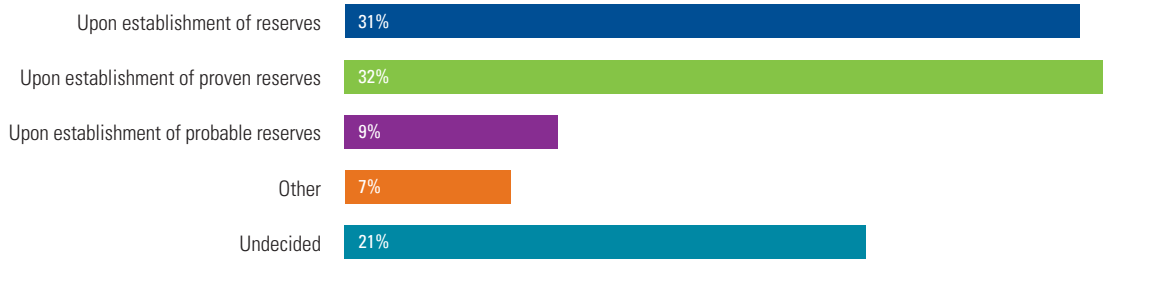
The responses to this question indicate a uniformity and consistency within the industry.

Do you intend to capitalize any administrative and general overhead costs both at the E&E phase and in the production/development phase?



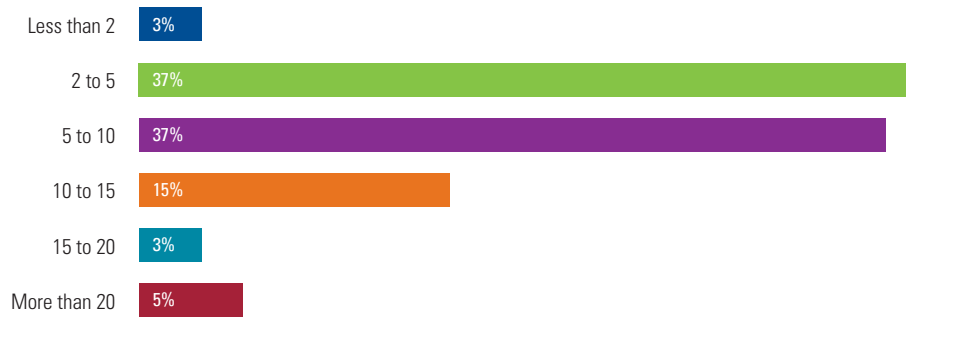
The results to this question are not surprising, but they are also not without comment. For the 55 percent who responded “Yes” in both phases, please be aware that only directly attributable overhead costs are allowed—general overhead is not. We would not be surprised as we move closer to the actual implementation date that, for ease of accounting, more companies will move more towards expensing all general and administrative costs.

At what point do you intend to transfer assets out of IFRS 6 (i.e. once technical feasible and commercial viability are demonstrable)?



Seventy-two percent of respondents included some form of establishment of reserves, be it proven and/or probable, which is definitely the trigger to be commercially viable. We believe as an industry, for conventional plays, we should move closer to “upon establishment of any proven and/or probable reserves.”

How many cash-generating units (CGUs) will you have?



Seventy-four percent of respondents are planning to have two to 10 CGUs. The surprising part of these results, given the sample, is the number of respondents who are planning for more than 15 CGUs. These respondents are most likely on the larger end of the Intermediate scale or are operating lands with unique cash in-flows. It should also be noted that we believe that only very small start-ups can justify two CGUs or less.



Within a CGU, how many components have you identified, i.e. how many separate depletion/depreciation calculations are done per CGU?



Sixty-one percent of respondents are planning on between two and 10 components within a CGU. More than 10 components could result in a high volume of depletion and/or depreciation calculations. However, this may be reasonable, if you have major oil and gas operations in North America, as it may be important to have an automated system in place to make these calculations for you.

Do you anticipate identifying any additional obligations under IFRS, i.e. Canadian GAAP is legal obligations, while IFRS is more broad than just legal?



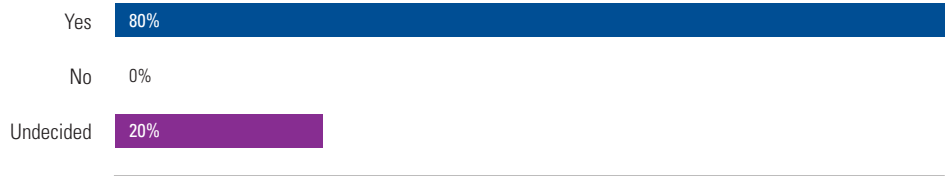
It appears that the majority of the respondents do not have onerous contracts or constructive obligations to record in transition.

What discount rate do you currently anticipate applying in the asset retirement obligation (ARO) calculations?



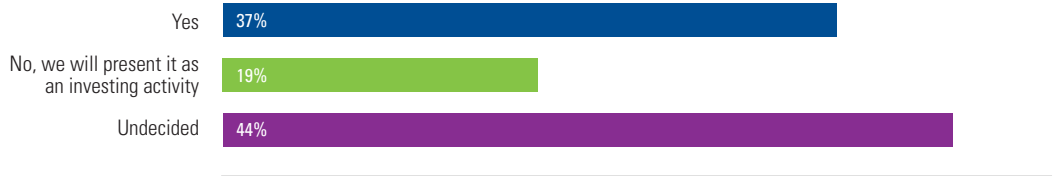
As expected, this has become a key issue for the Oil & Gas industry within IFRS. There is mixed practice and we are hoping that the International Accounting Standards Board (IASB) provides more clarity. As a firm, KPMG currently only supports the use of the risk-free rate for ARO calculations, as we believe the cash flows are risk adjusted and that an entity's credit risk should not be included in the discount rate.

In your IFRS financial statements, will you report cash flows from operating activities under the indirect method (as currently done by most entities under Canadian GAAP)?



Obviously, the vast majority of respondents will report under the indirect method.

In your IFRS financial statements, will you classify interest received as an operating activity?



The number of undecided respondents to this question can probably be interpreted as companies taking a “wait and see” approach to classification of interest. For those who did select “Yes” or “No,” although interest can be classified as an operating activity, classification of interest as an investing activity provides a better presentation of operating cash flow.

In your IFRS financial statements, will you classify interest paid as an operating activity or financing activity (IFRS allows for a policy choice)?



We believe classification of interest paid as a financing activity is appropriate and also consistent with the classification of interest income as a financing activity.

In your IFRS financial statements, will you classify dividends paid as an operating activity?



Obviously selecting “No” is similar to Canadian GAAP and, similar to other questions in the survey, one could expect that a large majority of the “Undecided” respondents will migrate to the “No” category as they move closer to implementation.

In your IFRS financial statements, will you present expenses in the income statement by function or nature, (i.e. cost of sales, distribution, administration)?



We can understand the relatively even distribution between all three responses and a large number of "Undecided" respondents. Our example financial statements that were distributed earlier this year were set out by the nature of expenses. The majority of the European Oil & Gas companies also follow a mixed-method presentation.

In your IFRS financial statements, will you present unrealized and realized gains and losses within revenue?



Upon first inspection of the results to this question, it is easy to see that the two options for "No" responses combine for an overwhelming 73 percent majority. Although there is varied practice in Canadian GAAP, the preferred approach would be to combine them on one line as financing. Please refer to our sample financial statements to see this approach.

Based on your analysis to date, do you currently expect your trust units to be presented as liabilities or equity under IFRS?



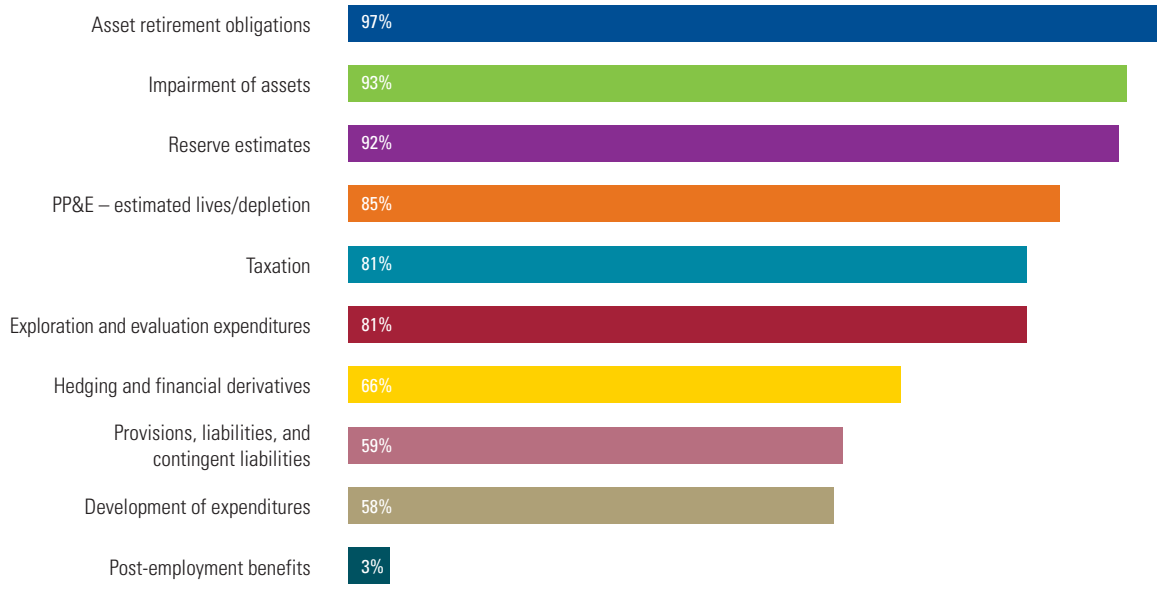
Presenting as equity is likely going to be the most popular, but given the large number of non-respondents, there are too many votes outstanding to truly determine what the majority will be. We believe the majority of respondents want to present as equity, but we think the decision is now based on the fact set. The position has been clarified and discussed between the major accounting firms. For those of you who have not discussed this issue with your auditors, you should do so soon.

Where will you be reporting royalty expenses in the income statement?



As expected, the continuation of current Canadian GAAP for reporting royalty expenses as a deduction from gross revenue is the overwhelming majority, but it is still under considerable debate. This is certainly an ongoing issue and we will keep you updated on progress and developments.

Which of the following do you expect to disclose as critical accounting policies and estimates? (Please select all that apply)



As could have been predicted, the industry is in agreement on the top six or seven critical policies and estimates.



Have you determined a difference under IFRS in the classification of royalties and other mineral taxes, i.e. classified as a royalty expense under Canadian GAAP and tax under IFRS?



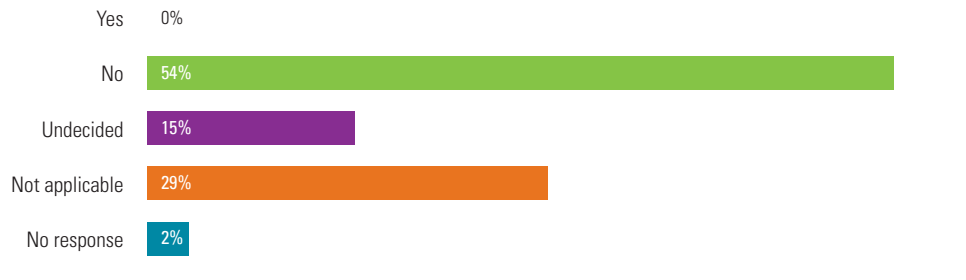
As anticipated, this is another issue where there is obviously a large number of undecided respondents who are still building their own opinions or waiting to follow their industry peers. For those who are "Undecided," it appears many have concluded that a royalty is a deduction from revenue.

Do you anticipate any changes in your current functional currency evaluations, including the Canadian parent company?



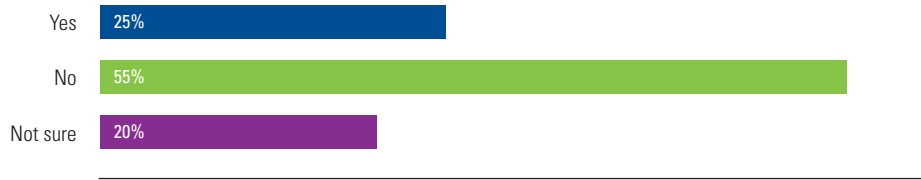
Given the sample size and respondents for this survey, these results are not surprising. A "No" response rate of 85 percent makes sense, as most respondents are primarily focused on operations in Canada.

Has the review of lease contracts under IFRS caused any material changes in the classification for leases, i.e. currently classified as operating under Canadian GAAP but capital leases under IFRS?



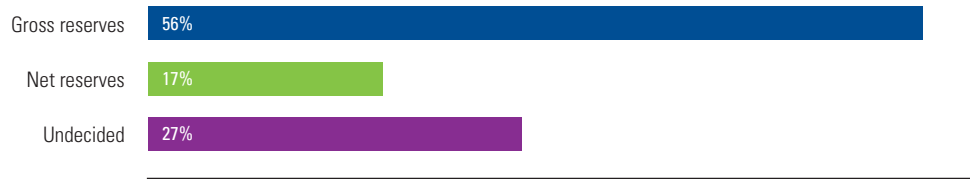
We are surprised at these results; we think there are a number of leases that will become financing under IFRS, although many of them may not be material. Of course, this may all substantially change as the existing lease standard under IFRS is revised. It is currently expected that all operating leases will be moved to the balance sheet.

Do you expect to have either a goodwill or oil and gas asset impairment on transition?



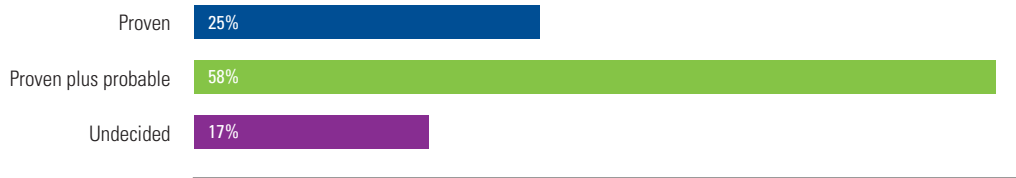
Even with 20 percent of respondents undecided on the issue, the majority of them are not expecting impairment upon transition. We are surprised by this response, as we believe that the respondents with oil and gas assets may experience a more stringent threshold on the required impairment test (mandated if using IFRS 1 exemption). The IFRS oil and gas asset impairment test moves directly to step two of the ceiling test.

Are you going to be using gross or net reserve and production in your depletion calculations?



We believe this is a policy choice and will be surprised if more than a minority will ever use net reserves.

Are you planning to use proven or proven plus probable reserves in your depletion calculations?



We are surprised that 25 percent of respondents are using only proven reserve values. It is definitely worth calculating your depletion under both methods in your transition assessment. We believe the majority of juniors have chosen proven plus probable, while some entities are leaning towards proven because of the uncertainty of future development costs.

Do you have your mock IFRS financial statements ready?



It looks as if the industry has a long way to go by January 1, 2011.

When do you plan to present your draft financial statements to your Audit Committee?



We are encouraged to see that 80 percent of respondents are planning to present statements to their Audit Committees before the end of October 2010.



Extractive Industries Discussion Paper

With the transition to International Financial Reporting Standards (IFRS), you have probably recognized that extractive activities is an area in which there is little guidance. A project on extractive activities was initiated by the predecessor body of the IASB, the International Accounting Standards Committee (IASC), as long ago as 1998. Since then, progress has obviously been slow.

The work of the IASB culminated in the creation and issuance of a draft discussion paper on April 6, 2010. This discussion paper represents the recommendations of the project team, but does not include the preliminary views of the IASB. Comments on the discussion paper are due to the IASB by July 30, 2010.

Although the IASB has had other priorities given the economic events of the past 18 months, we believe it is important that an accounting standard be issued as soon as possible. To this point, we have documented our views in a publication entitled *New on the Horizon: Extractive Industries*, which summarizes the issues from the discussion paper. If you have not already done so, we encourage you to take a moment to review the discussion paper and provide your comments to the IASB. It can be downloaded from the KPMG website at the following link: www.kpmg.ca/en/industries/enr/NewHorizon.html.

About KPMG

KPMG is one of Canada's leading auditors to the Energy industry. We have built multidisciplinary teams of Audit, Tax, and Advisory professionals who focus exclusively on the companies in this industry. Our professionals have relevant industry backgrounds and devote their talent and tactical skills to help our clients grow, enhance shareholder value, and succeed in the marketplace.

We see the Energy industry as a pivotal industry across the globe, and we are committed to standing out from the pack among international financial audit, advisory, and taxation advisers. Our discussions with leading companies in the Energy industry have convinced us that the key to winning confidence and delivering truly valuable approaches to businesses is to deliver high level financial and commercial advice, combined with consistent, specific, and practical industry knowledge.

Headquartered in Calgary, KPMG's Energy practice is a high priority for the firm. With over 40 partners and associate partners focusing on energy, our goal is to continue to build upon our solid history of providing quality service to the sector.

Service Excellence

At KPMG, we are passionate about earning your trust through extraordinary service. We take deep personal accountability, individually and as a team, to deliver exceptional service and value in all our dealings with you. At the end of the day, we measure our success from the only perspective that matters—yours.

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