January 2004

Basis for Conclusions
ED 6

BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT

ED 6 Exploration for and Evaluation of Mineral Resources

Comments to be received by 16 April 2004

International
Accounting Standards
Board®

Basis for Conclusions on Exposure Draft

ED 6 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

Comments to be received by 16 April 2004

This Basis for Conclusions accompanies the proposed International Financial Reporting Standard (IFRS) set out in ED 6 *Exploration for and Evaluation of Mineral Resources* (see separate booklet). Comments on the draft IFRS and the Basis for Conclusions should be submitted in writing so as to be received by **16 April 2004**.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org** or addressed to:

Colin Fleming
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH, United Kingdom

Fax: +44 (0)20 7246 6411

ISBN for this part: 1-904230-38-5
ISBN for complete publication (two parts): 1-904230-39-3

Additional copies of this publication may be obtained from:
IASCF Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@iasb.org Web: www.iasb.org

Contents

Basis for Conclusions

ED 6 Exploration for and Evaluation of Mineral Resources

Basis for Conclusions on ED 6 Exploration for and Evaluation of Mineral Resources

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

INTRODUCTION

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in ED 6 *Exploration for and Evaluation of Mineral Resources.* Individual Board members gave greater weight to some factors than to others.

BC2 An International Financial Reporting Standard (IFRS) addressing exploration for and evaluation of mineral resources is needed because:

(a) there is at present no IFRS that specifically addresses the accounting for expenditures for the exploration for and evaluation of mineral resources, and such activities are excluded from the scope of [draft] IAS 38 *Intangible Assets*.* In addition, mineral rights and mineral resources such as oil, natural gas and similar non-regenerative resources are excluded from the scope of IAS 16 *Property, Plant and Equipment*. Consequently, an entity is required to determine its accounting policy for such exploration and evaluation expenditure in accordance with paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

(b) there are different views on how exploration and evaluation expenditures should be accounted for under IFRSs.

(c) accounting practices for exploration and evaluation assets under the generally accepted accounting practices of other standard-setting bodies are diverse and often differ from practices in other sectors for costs that may be considered analogous (eg accounting practices for research and development costs under [draft] IAS 38).

(d) exploration and evaluation expenditures represent a significant cost to entities engaged in extractive activities.

---

* in Exposure Draft of *Proposed Amendments to IAS 36, Impairment of Assets, and IAS 38*, *Intangible Assets* (December 2002)

(e) relatively few entities incurring exploration and evaluation expenditures present their financial statements in accordance with IFRSs, although many more are expected to do so from 2005.

BC3 The IASB's predecessor organisation, the International Accounting Standards Committee (IASC), established a Steering Committee in 1998 to carry out initial work on accounting and financial reporting by entities engaged in extractive activities. In November 2000 the Steering Committee published an *Issues Paper.* In response, 52 comment letters were received.

BC4 In July 2001 the Board announced that it would restart the project only when agenda time permitted. In September 2002 the Board decided it was not feasible to complete a comprehensive project in time for the many entities that will adopt IFRSs in 2005. Accordingly, the Board is focusing on what it views as the main issues for entities, including first-time adopters, engaged in the exploration for and evaluation of mineral resources. Although the Board recognises the importance of the treatment of exploration and evaluation expenditures, it noted that it was not feasible to complete the detailed analysis required for this issue, obtain appropriate input from constituents and undertake the Board's normal due process in time to implement changes before 2005.

BC5 In April and September 2003 the Board reached the following decisions in respect of the main issues for entities engaged in the exploration for and evaluation of mineral resources:

(a) IFRSs should apply to entities engaged in the exploration for and evaluation of mineral resources, except to the extent that an IFRS excludes such activities from its scope.

(b) Entities, including first-time adopters of IFRSs, may continue to account for exploration and evaluation expenditures using existing accounting policies. However, if an entity that recognised an exploration and evaluation asset wished to change its accounting for that asset, it should be subject to the requirements for a voluntary change in accounting policy contained in IAS 8.

(c) In respect of exploration and evaluation assets, an entity should assess such assets for impairment annually. However, an entity may elect to adopt an alternative definition of a cash-generating unit for the purpose of applying the impairment test in [draft] IAS 36 *Impairment of Assets*.*

* in Exposure Draft of *Proposed Amendments to IAS 36, Impairment of Assets, and IAS 38*, *Intangible Assets* (December 2002)

APPLICATION OF IFRSs TO ENTITIES ENGAGED IN THE EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

BC6 In the Board's view, all IFRSs (including International Accounting Standards and Interpretations) are applicable to entities engaged in the exploration for and evaluation of mineral resources that make an unreserved statement of compliance with IFRSs in accordance with IAS 1 *Presentation of Financial Statements*. Consequently, each IFRS must be applied by all such entities, except to the extent that an IFRS provides an exclusion from its scope.

BC7 Some entities recognising exploration and evaluation assets take the view that, in the absence of a comprehensive IFRS on extractive industries, it would be permissible for an entity adopting IFRSs to continue to apply the related pronouncements of other standard-setting bodies without further consideration of IFRSs in general and the IASB *Framework* in particular. Paragraphs 10-12 of IAS 8 permit an entity developing an accounting policy in the absence of a specific IFRS requirement to consider a pronouncement of another standard-setting body only in limited circumstances. The entity must determine that the accounting policy meets the requirements in paragraph 10 of [draft] IAS 8. In doing so the entity must consider existing IFRSs dealing with similar and related issues and the *Framework*. In addition, pronouncements of other standard-setting bodies may be used only when they are developed in the context of a similar conceptual framework and are consistent with the *Framework* and IFRSs.

TEMPORARY CONTINUATION OF SOME EXISTING ACCOUNTING PRACTICES

BC8 The draft IFRS proposes to exempt entities from some requirements of other IFRSs and the *Framework*. Paragraphs 11 and 12 of [draft] IAS 8 specify the various sources of authoritative requirements and guidance, including the *Framework*, an entity would consider in developing an accounting policy for an item if no IFRS specifically applies. Instead of requiring entities engaged in the exploration for and evaluation of mineral resources to consider the various sources of authoritative requirements and guidance in developing an accounting policy for such activities, the Board proposes specifically to permit those entities the alternative of continuing their existing accounting treatment in certain circumstances.

In particular, the Board proposes to permit an entity recognising exploration and evaluation assets to continue to account for such assets in accordance with the accounting policies applied in its most recent annual financial statements.

BC9 Without the IFRS now proposed uncertainty might exist about whether an accounting policy for exploration and evaluation assets is consistent with IFRSs. Resolving this uncertainty might involve considerable cost and some entities might make major systems changes only to be required to make further significant changes in the event that when the Board is able to address the issues as part of a comprehensive project. To avoid unnecessary disruption in areas in which it intends to undertake a comprehensive analysis of accounting issues, the Board proposes to limit the need for entities to change their existing accounting practices for exploration and evaluation assets. The proposals in the draft IFRS would exempt an entity from considering the authoritative sources in paragraphs 11 and 12 of IAS 8 when assessing its existing accounting policies for exploration and evaluation assets.

BC10 Some suggest that the Board should expand the scope of IAS 16 and [draft] IAS 38 to include exploration and evaluation assets. They view exploration and evaluation expenditure as similar to research expenditure. [Draft] IAS 38 requires all research expenditure to be recognised in profit or loss in the period incurred and permits the recognition of a development asset in limited circumstances. Although the Board is concerned that existing accounting practices might result in the inappropriate recognition of exploration and evaluation assets, it is also concerned that accounting for exploration and evaluation expenditure in accordance with [draft] IAS 38 might result in an overstatement of expenses. There is no international consensus on the appropriate accounting treatment of such expenditure and further consideration and analysis is needed before the Board can make an informed judgement.

BC11 Therefore the Board agreed to permit entities to continue their existing accounting practices for the recognition of exploration and evaluation assets. However, the Board proposes to require any exploration and evaluation assets recognised to be tested for impairment using [draft] IAS 36 (see paragraphs BC15-BC27).

RECOGNITION OF EXPLORATION AND EVALUATION ASSETS

BC12 The draft IFRS proposes that an entity may continue to use the accounting policies applied in its most recent annual financial statements for exploration and evaluation assets. This includes the continuation of practices in respect of recognition and measurement when incorporated within such accounting policies. An entity may change its accounting policy for exploration and evaluation assets in accordance with the requirements for voluntary changes in accounting policy in IAS 8.

BC13 The definition of exploration and evaluation assets determines which expenditures the draft IFRS addresses and which expenditures should be accounted for in accordance with other IFRSs. Although the Board is willing to accept, as an interim measure, the continuation of existing accounting treatments for exploration and evaluation assets, it is unwilling to base the definition used for accounting purposes on local definitions that may vary from country to country.

BC14 Some express concerns that the adoption of a particular definition by the Board could lead to inappropriate changes in definitions used for other purposes, such as company law or tax. The Board emphasises that any definition used in IFRSs is solely for accounting purposes and is not intended to change or pre-empt definitions used for other purposes.

Measurement after Recognition

BC15 The draft IFRS permits an entity recognising an exploration and evaluation asset to measure such an asset after recognition using either the cost model or the revaluation models in IAS 16 and [draft] IAS 38. Those revaluation models permit the revaluation of assets when specified requirements are met (see paragraphs 31-42 of IAS 16 and paragraphs 70-84 of [draft] IAS 38). The revaluation model in [draft] IAS 38 can be used only if the asset's fair value can be determined by reference to an active market; the revaluation model in IAS 16 does not and refers only to 'market-based evidence.' Some Board members are troubled by this inconsistency and are concerned that entities might choose accounting policies to achieve a more advantageous measurement of exploration and evaluation assets. However, the Board concluded that, although the revaluation of an exploration asset in accordance with IAS 16 and [draft] IAS 38 may not be widespread, it is appropriate not to require use of only the cost model in either Standard for exploration and evaluation assets.

IMPAIRMENT OF EXPLORATION AND EVALUATION ASSETS

The level at which impairment is assessed

BC16 [Draft] IAS 36 requires an impairment loss to be recognised when the carrying amount of an asset exceeds its recoverable amount. When it is not possible to estimate the recoverable amount of an individual asset, an entity must determine the recoverable amount of the cash-generating unit to which that asset belongs. The Board is of the view that it is important that draft IAS 36 applies to all assets, including exploration and evaluation assets, because otherwise assets might be carried at an amount exceeding recoverable amount.

BC17 However, the Board is also concerned that requiring entities to use the definition of a cash-generating unit in paragraph 5 of [draft] IAS 36 when assessing exploration and evaluation assets for impairment would negate the effects of the other proposals in this draft IFRS and might result in the inappropriate recognition of impairment losses in some circumstances.

BC18 The Board understands that the definition of a cash-generating unit in [draft] IAS 36 might create uncertainty about whether existing accounting policies are consistent with IFRSs. This is because exploration and evaluation assets would often not be expected:

(a) to be the subject of future cash inflow and outflow projections relating to the development of the project, on a reasonable and consistent basis, without being heavily discounted because of uncertainty and lead-times;

(b) to have a determinable net selling price; or

(c) to be readily identifiable with other assets that generate cash inflows as a specific cash-generating unit.

The implications of (a)-(c) are that an exploration and evaluation asset would often be deemed to be impaired if the existing definition of a cash-generating unit was applied.

BC19 To avoid the outcome identified in paragraph BC17, the draft IFRS proposes a definition of a cash-generating unit for exploration and evaluation assets. When an entity recognising an exploration and evaluation asset first applies the draft IFRS, it would elect to apply to such assets the definition of a cash-generating unit in paragraph 5 of [draft] IAS 36 or the definition of a cash-generating unit for exploration and evaluation assets. As defined by the Board, the cash-generating unit for exploration and evaluation assets is the cash-generating unit that represents the smallest identifiable group of assets that, together with exploration and evaluation assets, generates cash inflows from continuing use to which impairment tests were applied by the entity under the accounting policies applied for its most recent annual financial statements. However, the impairment test to be applied is the one required by [draft] IAS 36.

BC20 The Board acknowledges that creating the notion of a special cash-generating unit is unusual. The Board concluded that such a decision was necessary to give effect to its interim approach to the recognition and measurement of exploration and evaluation assets. However, it also sought to impose some discipline on the definition of a cash-generating unit for exploration and evaluation assets, without which the relevance and reliability of the entity's financial statements would be adversely affected to an unacceptable degree. Consequently, the Board proposes that a cash-generating unit for exploration and evaluation assets shall be no larger than a segment, as defined in IAS 14 *Segment Reporting*. The Board could not identify any valid reasons why it should permit an entity to assess exploration and evaluation assets for impairment at a level higher than a segment.

BC21 IAS 14 requires entities whose equity or debt instruments are publicly traded to disclose segment information for all reportable segments. A reportable segment is a business segment or a geographical segment identified on the basis of the definitions in IAS 14. IAS 14 provides that an entity's business and geographical segments for external reporting purposes should be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's past performance and for making decisions about future allocations of resources. The Board notes that IAS 14 also provides that two or more internally reported business segments or geographical segments may be combined as a single business segment or geographical segment when they are substantially similar, ie:

(a) they exhibit similar long-term financial performance and

(b) they are similar in all of the factors in the appropriate definition in IAS 14.

BC22 The Board is aware that some entities recognising exploration and evaluation assets assess impairment on the basis of an ‘area of interest’. However, the Board is of the view that such a level of assessment is appropriate only if the area of interest is no larger than a segment as defined in IAS 14.

BC23 Under the accounting policies applied for its most recent annual financial statements, an entity might have applied a test that was equivalent to an impairment test, whereby specified criteria had to be met to continue to recognise an exploration and evaluation asset. In the Board’s view, if an entity did not assess such assets for impairment under the accounting policies applied for its most recent annual financial statements using inputs similar to those in [draft] IAS 36, the test would not meet the requirements of that draft Standard. Consequently, it is not proposing that entities should continue existing practices with respect to the impairment test itself. Rather, the [draft] IAS 36 impairment test is applied at a different level from that which might otherwise be required by that Standard.

BC24 The Board noted that all assets other than exploration and evaluation assets included within the cash-generating unit for exploration and evaluation assets are subject to separate impairment testing under [draft] IAS 36. Such tests must be performed, and any related impairment losses recognised, before testing the exploration and evaluation assets for impairment.

Identifying an asset that may be impaired

BC25 The Board has proposed additional indicators of impairment to be included among the external and internal sources of information an entity considers when identifying whether exploration and evaluation assets might be impaired.

BC26 The Board considered the application of the external indicators of impairment in paragraph 9(b) of [draft] IAS 36 and, in particular, significant adverse market or economic changes that “…have taken place during the period, or will take place in the near future…”. The Board decided that in relation to these indicators, any significant adverse changes in an entity’s long-term view about prices or foreign exchange rates would be implicitly factored into the indicators of impairment for exploration and evaluation assets in paragraph 13 of the draft IFRS.

BC27 Although an entity is required to consider the indicators of impairment in paragraphs 9-13 of [draft] IAS 36, the Board concluded it was important to clarify the application of these paragraphs to exploration and evaluation assets. Paragraph 13 of the draft IFRS is of particular importance because the proposal that an entity may continue to use the accounting policies applied for its most recent annual financial statements may result in recognition of significant exploration and evaluation assets.

Reversal of impairment losses

BC28 The reversal of impairment losses when specified requirements (set out in paragraphs 109-122 of [draft] IAS 36) are met is required of all entities under IFRSs for all assets (excluding goodwill and equity investments classified as available for sale). Thus, the Board concluded it is appropriate not to propose an exemption from the requirement to reverse impairment losses for exploration and evaluation assets.

CHANGES IN ACCOUNTING POLICIES

BC29 The Board encourages entities to use IFRSs to improve their financial reporting. In particular, it encourages those entities electing to continue to apply existing accounting policies for exploration and evaluation assets to improve their accounting policies. However, the Board notes the requirement of IAS 8 paragraph 14(b), which states that an entity may change its accounting policies only if the change results in more relevant and reliable information in the financial statements.

CLASSIFICATION OF EXPLORATION AND EVALUATION ASSETS

BC30 The Board acknowledges that some exploration and evaluation assets are intangible, eg drilling or mining rights. However, for convenience, entities often combine such assets with other assets that are tangible. The Board notes that under existing practices of other standard-setting bodies, entities engaged in exploration for and evaluation of mineral resources typically classify exploration and evaluation assets as development assets or as a sub-category within mineral rights and development properties, both of which are typically treated as categories of property, plant and equipment. The Board also noted that exploration and evaluation assets, when classified separately, are typically transferred to the development costs asset class within property, plant and equipment once the decision to develop the mineral resource has been made.

BC31 The Board has not yet considered whether exploration and evaluation assets are tangible. Accordingly, entities may continue to classify such assets in accordance with the accounting policies applied in their most recent annual financial statements.

BC32 As noted in paragraph BC7, an entity that elects not to continue to apply the accounting policies applied for its most recent annual financial statements for the exploration for and evaluation of mineral resources is required to apply the criteria in paragraphs 10-12 of IAS 8 in developing an accounting policy for the exploration for and evaluation of mineral resources. The Board notes that such an entity should not apply paragraphs 4-10 of the draft IFRS by analogy in developing its accounting policy for exploration for and evaluation of mineral resources because the proposals in the draft IFRS are predicated on the suspension of the criteria in paragraphs 11 and 12 of IAS 8.

DISCLOSURE

BC33 To enhance comparability among entities engaged in extractive activities, particularly because the continuation of the accounting policies applied by an entity for its most recent annual financial statements will result in diverse treatment of the exploration for and evaluation of mineral resources under IFRSs, the Board proposes to require an entity to disclose:

(a) its accounting policies for exploration and evaluation expenditure including the recognition of exploration and evaluation assets.

(b) material amounts of assets, liabilities, income and expense (and, if it presents its cash flow statement using the direct method, cash flows) arising from the exploration for and evaluation of mineral resources.

(c) the level at which the entity assesses any exploration and evaluation assets recognised for impairment.

BC34 The Board is of the view that appropriate disclosure of accounting policies in accordance with IAS 8 is important, given the variety of accounting treatments for exploration and evaluation expenditures and the recognition of exploration and evaluation assets that would continue under the proposed IFRS.

BC35 The Board notes that disclosure of exploration and evaluation expenditure incurred and recognised as an expense in the period is required by all entities engaged in the exploration for and evaluation of mineral resources under IAS 1. The Board also notes that appropriate disclosures of impairment losses and any reversals of impairment losses relating to exploration and evaluation assets is required under [draft] IAS 36.

EFFECTIVE DATE

BC36 This draft IFRS is proposed to be applied for annual periods beginning on or after **1 January 2005**. Earlier application is encouraged.

BC37 The Board has stated its intention not to mandate changes to IFRSs between early 2004 and the end of 2005. This is to assist the many entities that wish or are required to adopt IFRSs on or before 1 January 2005 to do so without the additional concerns of new accounting standards becoming effective. Notwithstanding this, the Board is of the view that the proposals in the draft IFRS should facilitate an orderly transition to IFRSs and should not result in changes to existing accounting policies.

BC38 Without the IFRS now proposed, entities that have exploration and evaluation assets and wish or are required to adopt IFRSs on or before 1 January 2005 would be in a difficult position. In the absence of specific guidance, and given the scope exclusions contained in IAS 16 and [draft] IAS 38, an entity would be required to apply the hierarchy in IAS 8 paragraphs 11 and 12 when determining the appropriate treatment for exploration and evaluation assets under IFRSs. As explained in paragraphs BC8-BC11, the Board is concerned that this could lead to entities making major systems changes only to be required to make further changes when the Board addresses the issues as part of a comprehensive project. Therefore, the Board concluded that the most appropriate effective date is 1 January 2005.

APPENDIX
Alternative views on ED 6 *Exploration for and Evaluation of Mineral Resources*

AV1 Four Board members voted against the publication of ED 6 *Exploration for and Evaluation of Mineral Resources.* Their alternative views are set out below.

AV2 The Board members would not permit entities the alternative of continuing their existing accounting treatment for exploration and evaluation assets. In particular, they believe that all entities should be required to apply paragraphs 11 and 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing an accounting policy for exploration and evaluation assets. The Board members believe that the requirements in IAS 8 have particular relevance and applicability when an IFRS lacks specificities, as is the case for entities recognising exploration and evaluation assets. This is especially true because the draft IFRS allows the continuation of a variety of measurement bases for these items and, because of the failure to consider the IASB *Framework*, may result in the inappropriate recognition of assets. In the Board members' view, if an entity cannot meet those requirements, it should not be allowed to describe its financial statements as being in accordance with International Financial Reporting Standards.

AV3 The Board members also disagree with the decision to include the concept of a "cash-generating unit for exploration and evaluation assets" for the purpose of assessing exploration and evaluation assets for impairment. The Board members believe that the cash-generating unit defined in [draft] IAS 36 as applicable to other non-financial assets should be applied to exploration and evaluation assets. Failure to do so could result in exploration and evaluation assets continuing to be carried forward when such assets are not recoverable. This could result in the exclusion of relevant information from the financial statements because of the failure to recognise impairment losses on a timely basis and the inclusion of unreliable information because of the inclusion of assets that do not faithfully represent the transactions and other events that they purport to represent.

AV4 The Board members' concerns are heightened by the absence from the Board's work programme of a project on accounting for exploration for and evaluation of mineral resources generally. Although a research project is expected to begin in 2004, it is unlikely that the Board will be able to develop financial reporting standards in the near- to mid-term. Accordingly, it is likely that the proposed concessions will remain in place for some time.