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Project	**Extractive Activities**
Paper topic	Annual filings review

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Objective

1. As explained in Agenda Paper 19, this paper summarises our review of a sample of entities' annual filings to understand what information entities provide about exploration and evaluation (E&E) expenditure and activities.

Structure of this paper

2. This paper is set out as follows:
   (a) Background (paragraphs 3–4);
   (b) Process (paragraphs 5–14);
   (c) Findings (paragraphs 15–55);
   (d) Summary (paragraphs 56–57); and
   (e) Appendix—Details of sample.

Background

3. This paper summarises our review of a sample of annual reports filed by entities in the extractives industries as part of Phase I of the project (see March 2022 Agenda Paper

19). We reviewed each entity's financial statements and other information with the financial statements (annual filing) to understand what information entities provide about their E&E expenditure and activities in their annual filings. In particular, we focused on the three broad categories of information about E&E expenditure and activities which we identified through our review of previous feedback, academic research and jurisdictional requirements and other proposals (see Agenda Paper 19A). Those three broad categories were:

(a) information to help understand the accounting for E&E expenditure;

(b) information to help compare entities with different accounting policies for E&E expenditure; and

(c) information to help understand the risks and uncertainties of E&E activities.

4. As explained in Agenda Paper 19, this paper summarises our findings and Agenda Paper 19C analyses these findings.

Process

Sample selection

5. In 2020 we reviewed the financial statements of 1,531 entities to understand the diversity of accounting polices developed applying IFRS 6 *Exploration for and Evaluation of Mineral Resources*. We searched the Alphasense database for filings made in jurisdictions that require or permit IFRS Accounting Standards. The sample of 1,531 entities resulted in a broad range of entities across different jurisdictions, industry sub-sectors, of different sizes and with different activities (ranging from those with exploration-only activities to those with exploration, development and production activities). As our research demonstrated, these entities had a range of accounting policies for their E&E expenditure (see paragraphs 16–21 of October 2020 Agenda Paper 19A).

6. We reviewed the annual filings of a subset of these 1,531 entities to understand the information entities provide about their E&E expenditure and activities. We based our research on the October 2020 sample to ensure we reviewed entities with similarly diverse accounting policies for E&E expenditure since applying different accounting

policies might influence the information these entities provided about their E&E expenditure and activities. We sampled 77 (5%) of the entities reviewed in October 2020. This sub-sample was broadly representative of the original population in terms of different jurisdictions, industry sub-sectors, entity sizes, entity types (for example, exploration-only entities) and accounting policies applied to E&E expenditure. The Appendix compares the sub-sample to the original population.

7. In addition to the 77 entities, we also reviewed:

(a) five entities with the largest market capitalisation from the original sample. In our prior outreach one national standard-setter said larger mining entities tend to have more comprehensive and complex accounting policies.

(b) the annual filings from one entity from Latin America, one entity from Africa and one entity that adopted a 'full cost' accounting policy in order to improve the representation of entities reviewed.

Information we looked at

8. We reviewed the annual filings of the entities selected using CapitalIQ.[1] In most cases, the annual filing was the annual report. However, the CapitalIQ filings for Canadian entities comprised only the financial statements.[2]

9. We identified all information related to E&E expenditure and activities by searching for the word 'exploration' in the annual filing and reading the related paragraphs. Typically this included:

(a) 'project' summaries in the 'front half' of the annual report; and

(b) the primary financial statements and related notes for E&E expenditure recognised in the Statement of Comprehensive Income, and E&E assets recognised in the Statement of Financial Position. This included notes on:

(i) accounting policies for E&E expenditure; and

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[1] CapitalIQ is a financial intelligence database from Standard & Poor's. The database provides financial statement data for both public and private companies globally.

[2] Canadian listed entities are required to file Management's Discussion & Analysis (MD&A) relating to their annual financial statements. We also located and reviewed the MD&A for five of the Canadian entities in our sample.

(ii) significant accounting judgements and major sources of estimation uncertainty.

How we analysed the information

10. Following the identification of the three broad categories of information about E&E expenditure and activities (see paragraph 3), when we reviewed the information identified in the annual filings (see paragraph 9) we considered:

(a) what information entities provide about their accounting policies for E&E expenditure and whether any elements of these policies were unclear;

(b) whether the information entities provide about their E&E expenditure, E&E assets and cash flows from E&E activities, allows users of financial statements (users) to compare entities that have different accounting policies for E&E expenditure; and

(c) whether users receive sufficient information about the risks and uncertainties of E&E expenditure and activities, including whether information provided outside financial statements on E&E activities (for example management commentary on exploration projects) can be linked to information in financial statements.

Information to help understand the accounting for E&E expenditure

11. We reviewed whether the disclosed accounting policies explained:

(a) the nature of expenditure included in E&E assets recognised in the Statement of Financial Position, or in E&E expenditure recognised in the Statement of Comprehensive Income;

(b) the unit of account used to accumulate E&E expenditure;

(c) when capitalisation of E&E expenditure starts and stops;

(d) any conditions for capitalising E&E expenditure;

(e) whether the same accounting policy applies to all E&E projects;

(f) the classification of E&E assets—tangible or intangible; and

(g) how E&E assets are tested for impairment.

12. We also reviewed whether the entity identified any aspects of applying the accounting policy and related information for E&E expenditure as:

    (a) significant accounting judgements (applying paragraphs 122–124 of IAS 1 *Presentation of Financial Statements*); or

    (b) major sources of estimation uncertainty (applying paragraphs 125–133 of IAS 1).

Information to help compare entities with different accounting policies for E&E expenditure

13. We reviewed whether entities disclosed:

    (a) the amounts of E&E assets recognised in the Statement of Financial Position, E&E expenditure recognised in the Statement of Comprehensive Income and operating and investing cash flows from E&E activities in the Cash Flow Statement;

    (b) a reconciliation of the carrying amount of E&E assets at the beginning and end of the period; and

    (c) information about the cumulative spend on current 'projects' (for entities that adopted a policy of expensing E&E expenditure).

Information to help understand the risks and uncertainties of E&E activities

14. We reviewed whether entities:

    (a) provided operational information[3] about E&E projects in the 'front half' of the annual report. We also reviewed how easy it was to relate operational information provided in the 'front half' of the annual report to amounts included in the financial statements about the assets, liabilities, income, expenses and cash flows of the entity—for example whether an entity provides a breakdown of its E&E assets or expenditure by project.

    (b) provided information about the risks associated with E&E activities.

[3] Operational information generally refers to management's commentary on the entity's E&E projects. This might include information about the nature, location and status of the projects, together with the current period's activity and future planned activity for the projects.

(c) disclosed information about the stage of E&E projects in financial statements.

(d) disclosed information about the nature of E&E activities in financial statements—for example whether the project was a greenfield (in an area not adjacent to any other projects or proven reserves) or brownfield (in an area adjacent to proven reserves) project.

(e) distinguished between ‘exploration expenditure’ and ‘evaluation expenditure’ in financial statements.

Findings

15. This section details the findings from our review of annual filings in the three broad categories noted in paragraph 3.

Information to help understand the accounting for E&E expenditure

16. In almost all financial statements we reviewed we found information about accounting policies for E&E expenditure in the notes to those statements (the other financial statements were of entities that were not relevant to our analysis because, for example they did not apply IFRS Accounting Standards or their equivalent). We discuss in paragraphs 17–39 specific items of information disclosed. We focus this discussion on the areas that contribute to the diversity in accounting policies applied to E&E expenditure.

Unit of account

17. Almost all entities that capitalised E&E expenditure (including those that capitalised only costs of acquiring rights to explore) disclosed the unit of account used to capitalise the costs. Many of these entities applied an ‘area of interest’ accounting policy to E&E expenditure. Most of those entities were listed on the Australian Stock Exchange (ASX). Australia’s equivalent accounting standard to IFRS 6—AASB 6

Exploration for and Evaluation of Mineral Resources—requires entities to apply the ‘area of interest’ accounting policy to E&E expenditure.[4]

18. Some entities provided further information about the area of interest. For example a few entities said each area of interest is limited to a size related to a known or probable mineral resource capable of supporting a mining operation and one entity said the area of interest is either a well or field depending on the nature of the project.

19. However, most entities provided no further details about the area of interest. It was sometimes unclear how the area of interest disclosed within the accounting policy note related to the projects, licences, exploration areas, prospects, drill holes and geological areas referred to in the ’front half’ of the annual report.

20. Other units of account disclosed included:

    (a) exploration well;

    (b) exploration area;

    (c) geographic area;

    (d) property;

    (e) project;

    (f) field;

    (g) rights covered by a production sharing agreement or a licence; and

    (h) well, field or exploration area.

21. It is not clear how similar or different these units of account (including area of interest) are. For example, for some entities a project might represent one licence and therefore these two terms (‘project’ and ‘licence’) have the same meaning, but for other entities a project may comprise several licences that are located in a similar area. Further information on the unit of account could help users:

    (a) understand the size of unit of account;

[4] AASB 6 defines an area of interest as ‘An individual geological area which is considered to constitute a favourable environment for the presence of a mineral deposit or an oil or natural gas field, or has been proved to contain such a deposit or field’.

(b) assess how conservative different entities' accounting policies are (for example, at what level of granularity management monitors information to assess when a unit of account is considered abandoned—the larger the unit of account, the longer the E&E asset might remain on the Statement of Financial Position); and

(c) compare entities with different accounting policies.

22. A lack of clarity about the size of the unit of account could also lead to a lack of clarity about how entities treat unsuccessful exploration. A few entities (all in the oil and gas industry) applied a 'successful efforts' accounting policy to E&E expenditure.[5] The accounting policies of these entities indicated that costs directly associated with an exploration well were capitalised pending evaluation. If no potentially commercial hydrocarbons were discovered, the costs were expensed in the Statement of Comprehensive Income.

23. However, for entities that applied other accounting policies, for example area of interest, it was not always clear whether costs of unsuccessful exploration were expensed or continued to be carried forward (assuming the potential to find commercial hydrocarbons or minerals remains for the area of interest as a whole). Many of the area of interest accounting policy disclosures for example, explained that costs were written off when a decision to abandon the area of interest is made or the project is determined not to be viable. If costs of unsuccessful exploration can be carried forward pending (a) a decision to abandon the area of interest; or (b) a determination that the area of interest is not viable, information to understand the size of the area of interest could be useful.

24. We did not find examples of accounting policy disclosures that suggested an entity carries forward the costs of unsuccessful exploration. However, a few entities disclosed that following an initial discovery of hydrocarbons, the cost of appraisal wells to determine the size, characteristics and commercial potential of a reservoir can

[5] Only E&E expenditure associated with successfully locating new minerals or oil and gas reserves is capitalised; costs are generally accumulated by well and are initially deferred to the balance sheet until the results of drilling are known.

remain capitalised, even if they do not find hydrocarbons, as long as further appraisal activity was planned.

25. Most of the accounting policies we reviewed disclosed information on the impairment testing of E&E assets. IFRS 6 requires an entity to determine an accounting policy for allocating E&E assets to cash-generating units or groups of cash-generating units. Although some of the accounting polices did disclose the cash-generating unit E&E assets were allocated to, most did not. However, this might be because the entity tests the E&E asset for impairment rather than allocating it to a cash-generating unit.

26. For entities applying a 'successful efforts' accounting policy, it was sometimes unclear how the costs of unsuccessful exploration interact with the accounting policy for impairing E&E assets. For example, one entity assessed E&E expenditure for impairment at the E&E asset or cash-generating unit level (which was usually represented by an exploration permit or licence). Although the accounting policy explains only the costs of successful wells remain capitalised, it was not clear whether, if the E&E expenditure is tested for impairment at the cash-generating unit level, costs of unsuccessful wells can be carried forward if supported by the value of the wider cash-generating unit. On the other hand, another entity's accounting policy was clear that the level of the cash-generating unit tested for impairment and the level at which unsuccessful exploration was assessed—the exploration well—were the same.

E&E expenditure

27. Paragraph 9 of IFRS 6 contains a non-exhaustive list of expenditures that might be included in the initial measurement of E&E assets:

(a) acquisition of rights to explore;

(b) topographical, geological, geochemical and geophysical studies;

(c) exploratory drilling;

(d) trenching;

(e) sampling; and

(f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

28. Many entities disclosed the types of expenditure included as E&E expenditure (whether expensed or capitalised). Some of these entities provided this information through disclosing a breakdown of the E&E asset or E&E expenditure expensed, rather than in their accounting policies.

29. Our research of accounting policies for E&E expenditure in October 2020 (see Agenda Paper 19A) highlighted diversity in whether geological and geophysical costs were capitalised. In the sample of annual filings we reviewed, many entities explained how geological and geophysical costs were treated. However, many other entities did not, although it was not clear whether these entities had material geological and geophysical costs. We found similar results when we reviewed the accounting policy disclosures to understand whether and to what extent overheads were included in E&E expenditure (capitalised or expensed). A few entities also highlighted the allocation of overheads between E&E expenditure and operating expenditure as a significant accounting judgement.

30. Many entities that recognise E&E assets also recognised some E&E expenditure in the Statement of Comprehensive Income. For many of these entities it was not always clear which elements of E&E expenditure were recognised in the Statement of Comprehensive Income and why these costs were expensed rather than capitalised.

31. Understanding the extent of costs included in E&E expenditure, particularly when that expenditure is also capitalised, could be useful and could help users compare financial statements of different entities.

When capitalisation starts and stops

32. Most accounting policies for E&E expenditure were relatively straightforward, for example:

    (a) All E&E expenditure is expensed except for costs associated with the acquisition of mineral rights;

    (b) All E&E expenditure is expensed including the costs associated with the acquisition of mineral rights; or

(c) All E&E expenditure incurred once the legal right to explore has been obtained are capitalised as E&E assets until the technical feasibility and commercial viability of the E&E assets are demonstrable.

33. However some entities had accounting policies which involved more judgement and set a threshold in determining when to start capitalising E&E expenditure. For example:

(a) a few entities capitalised E&E expenditure only if economic benefits from the expenditure are considered to be more likely than not;

(b) a few entities expensed exploration costs but capitalised costs associated with evaluation activities and, for example, explained that the evaluation phase starts from the beginning of the 'definitive feasibility study' or when management consider there is a high degree of confidence the project will be commercially viable; and

(c) one entity distinguished between greenfield and brownfield properties, expensing all greenfield costs not supported by an internal economic assessment and capitalising costs associated with brownfield properties.

34. Even when entities followed a relatively straightforward capitalisation policy such as that outlined in paragraph 32(c), the accounting policies of many such entities highlighted conditions that must be met to justify capitalising E&E expenditure. AASB 6 includes additional requirements to those included in IFRS 6, and one such paragraph lists the conditions that these entities (including some outside of Australia) referred to:

> Aus7.2 An exploration and evaluation asset shall only be recognised in relation to an area of interest if the following conditions are satisfied:
>
> (a) the rights to tenure of the area of interest are current; and
>
> (b) at least one of the following conditions is also met:
>
> > (i) the exploration and evaluation expenditures are expected to be recouped through successful development and exploitation of the area of interest, or alternatively, by its sale; and

(ii) exploration and evaluation activities in the area of interest have not at the end of the reporting period reached a stage which permits a reasonable assessment of the existence or otherwise of *economically recoverable reserves*, and active and significant operations in, or in relation to, the area of interest are continuing.

35. Many of these entities disclosed their assessment of whether these conditions were met as a significant accounting judgement (applying paragraphs 122–124 of IAS 1).

36. Most entities that had an accounting policy of capitalising at least some E&E expenditure indicated the uncertainty associated with E&E assets. These entities either disclosed the conditions that must be met in order to capitalise that expenditure, disclosed that costs were capitalised pending an assessment of commercial viability and technical feasibility or labelled the assets as ‘deferred’ E&E expenditure.

37. There were examples when the listing of the conditions for capitalising E&E expenditure could be confusing. For example, an entity’s accounting policy disclosure listed AASB 6 conditions (see paragraph 34 above) and also said E&E expenditure is capitalised only when future economic benefits are considered more likely than not. In this situation it could be unclear whether E&E costs are capitalised only when future economic benefits are considered more likely than not or whether, as the conditions in AASB 6 permit, E&E costs are capitalised even if activities have not reached a stage that permits this assessment to be made.

38. IFRS 6 requires an entity to no longer classify an E&E asset as such when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable. Many entities provided information about how they assessed whether commercial viability and technical feasibility were demonstrable and when they reclassified E&E assets. Examples of explanations included:

(a) when the board decides to develop the project;

(b) when proved reserves have been discovered;

(c) when permits to develop are in place; and

(d) when a ‘bankable feasibility study’ is in place.

39. However, many other entities provided no information about this assessment, although this might be because these entities did not consider this to be material information given their circumstances.

Information to help compare entities with different accounting policies

40. Most entities capitalised E&E expenditure. However, some entities expensed all E&E expenditure or capitalised only costs associated with the acquisition of mineral rights. Almost all entities that capitalised E&E expenditure disclosed their E&E assets separately. Similarly many entities disclosed amounts of E&E expenditure expensed in the Statement of Comprehensive Income in the period.[6]

41. The Statements of Comprehensive Income and Statements of Financial Position could significantly differ for entities with different accounting policies for E&E expenditure, making comparisons of these entities difficult.

42. One entity that expensed all E&E expenditure disclosed in its financial statements the cumulative exploration costs by project. This disclosure provides information about cumulative E&E expenditure similar to that required by IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* if entities capitalise their E&E expenditure. This information could help users track E&E expenditure and compare entities with different accounting policies.

43. One other entity that expensed its E&E expenditure disclosed a split of the annual E&E expenditure (with comparative) by geographical region.

Information to help understand the risks and uncertainties of E&E activities

44. E&E activities typically involve risks and uncertainties. There is generally uncertainty about whether E&E activity will result in the discovery of mineral resources that can be extracted.

[6] For those entities that did not provide separate disclosure of E&E assets or E&E expenditure expensed, we could not tell whether this was because the information was immaterial.

45. Most entities provided some information on these risks and uncertainties. Some entities provided this information outside the financial statements in a section discussing risks facing the entity. The types of risks and uncertainties included:

(a) speculative nature of exploration;

(b) requirement for substantial expenditure;

(c) availability of equipment;

(d) title risk and limitations on activities due to permitting requirements;

(e) commodity-price risk;

(f) foreign exchange risk;

(g) risks related to geographical location (for example, remoteness);

(h) climate risk;

(i) political risk;

(j) tax risk; and

(k) exposure to cost increases.

46. Many entities disclosed some information about risks and uncertainties of E&E activities in financial statements. For example:

(a) some entities disclosed information about some risks and uncertainties when explaining judgements associated with the recoverability of E&E assets. Entities explained that the recoverability depended on, for example, the level of reserves and resources, future technological changes, costs of drilling and production, future legal changes (including changes to environmental restoration obligations and other jurisdictional law changes) and changes to commodity prices and exchange rates.

(b) many entities disclosed risks associated with title to exploration rights and risks associated with attracting sufficient funding for future E&E activities.

47. In addition, as explained in paragraph 36, most entities disclosed information that provided some indication of the uncertainty associated with their E&E assets.

48. However, generally information about risks and uncertainties, both inside and outside the financial statements, referred to the entity's exploration activities more generally, rather than providing information about specific risks and uncertainties associated with particular E&E activities or projects—for example, that the entity's exploration activities are subject to geological, locational or political risks rather than that a particular project is risky because of the geology of the area it is exploring or the remoteness of the site or the country the project is located in.

49. As explained in paragraph 33, the accounting policies of some entities set a threshold for capitalising E&E expenditure. These policies can provide some insight into the nature or stage of E&E activities and therefore, some information on the risks and uncertainties associated with the E&E activities. For example:

    (a) exploration on a brownfield site is likely to be less risky than exploration on a greenfield site. The accounting policy of the entity in paragraph 33(c) would help users distinguish between the two types of E&E activity.

    (b) for an entity that has an accounting policy of expensing exploration costs and capitalising evaluation costs, this accounting policy could provide information about the stage of E&E activities and some information about the risks and uncertainties of the E&E activities. This is because exploration activity, being at an earlier stage, is likely to be riskier than evaluation activity.

50. Many of the annual filings provided information about the entity's E&E activities outside of the financial statements. Most of the entities that provided this information were listed in Australia. These entities provided operational details of their E&E activities by, for example, project or property, and this typically included maps of the sites of the properties (often with details of other nearby properties or discoveries), seismic details of geological formations in the areas, details of the permitting arrangements, together with narrative descriptions of the current period activity, technical drilling information (results, type of drilling activity, depths, and so on) and planned E&E activity for the future.

51. Although not as detailed as the information provided by most Australian listed entities in the sample, most MD&A of entities listed in Canada we reviewed (see paragraph 8)

also provided information on E&E activities by project. Many entities listed in other jurisdictions also provided similar operational information.

52. This information could help users understand the nature of the E&E activities, for example whether the activities are at an early-stage, whether the activities are in a remote location or in a location where other discoveries have been made, and the progress made on different projects.

53. However, it was often difficult to link the information outside the financial statements, which provided insight into the risks and uncertainties of E&E activities and expenditure, to amounts in the financial statements. For example entities would provide a summary of the status and activities for each project for the current period in the 'front half', however the financial statements would only contain a single amount for E&E expenditure either in the Statement of Comprehensive Income, the Statement of Financial Position or the Cash Flow Statement. It was difficult to understand how much of that expenditure related to the different activities performed on the different projects.

54. There were exceptions:

(a) a few entities provided, outside financial statements, an analysis of E&E expenditure split by project or geography, linking it to the operational information.

(b) some entities, mostly those listed in Canada, disclosed a breakdown of their fixed asset note in the financial statements by major project. This could link E&E activity information in the 'front half' with amounts recognised as E&E assets.

(c) one Canadian entity that expensed all E&E expenditure other than costs associated with acquisition of mineral rights, disclosed a split of its E&E expenditure in the Statement of Comprehensive Income by geography.

(d) one Canadian entity that expensed all E&E expenditure disclosed in its financial statements the cumulative exploration costs by project.

(e) a few entities disclosed information in their segment information note to the financial statements, providing the split of E&E expenditure or assets by geography. This information could help link the operational information on E&E activities provided outside the financial statements.

55. There were also some entities that disclosed information in financial statements that could provide some information about the nature or stage of E&E activities. For example, one entity disclosed brief operational information in its fixed asset note.

Summary

56. Our review of a sample of entities' annual filings provided evidence of what information entities provide about their E&E expenditure and activities in the three broad categories that we had identified in Agenda Paper 19A:
    - (a) information to help understand the accounting for E&E expenditure;
    - (b) information to help compare entities with different accounting policies for E&E expenditure; and
    - (c) information to help understand the risks and uncertainties of E&E activities.

57. As explained in Agenda Paper 19, Agenda Paper 19C analyses the findings in this agenda paper and Agenda Paper 19A.

Appendix—Details of sample

A1. The following tables compare the sub-sample of 77 entities to the original population of 1,531 entities (see paragraphs 5–7) by:

(a) geographical region of their stock exchange listing;

(b) industry sub-sector; and

(c) accounting policies.[7]

Geographical region

Region	% of sub-sample	% of original population
Africa	0[8]	1
Asia (incl. the Middle East)	4	6
Europe (incl. Russia)	12	12
Latin America and the Caribbean	0[9]	1
North America	35	32
Oceania	49	48
Total	**100**	**100**

[7] See paragraph 21(e) of Agenda Paper 19A to the October 2020 IASB meeting.

[8] As explained in paragraph 7(b) we sampled one entity from this category to improve the representation of the sample.

[9] As explained in paragraph 7(b) we sampled one entity from this category to improve the representation of the sample.

Industry sub-sector

Industry sub-sector	% of sub-sample	% of original population
Minerals	82	76
Oil and gas	14	20
Other	4	4
Total	**100**	**100**

Accounting policies

Accounting policies	% of sub-sample	% of original population
Capitalisation—area of interest	54	47
Capitalisation—full cost	0[10]	1
Capitalisation—successful efforts	4	5
Capitalisation—unknown	22	22
Expense—as incurred	3	6
Expense—subsequent expenditure	9	13
Unknown	0	2
Not applicable	8	4
Total	**100**	**100**

[10] As explained in paragraph 7(b) we sampled one entity from this category to improve the representation of the sample.