STAFF PAPER

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Project	**Extractive Activities**		
Paper topic	Applying IAS 16 and IAS 38 to exploration and evaluation expenditures		
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Objective

1. The objective of this paper is to present the staff's research findings on how activities within the scope of IFRS 6 *Exploration for and Evaluation of Mineral Resources* would be accounted for in the absence of that Standard applying the requirements in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

2. This paper does not contain any questions for the Board.

Overview

3. This paper is structured as follows:

   (a) Scope of research (paragraphs 4-10);

      (i) Assumptions applied (paragraphs 7-10);

   (b) Applying IAS 16 to exploration and evaluation expenditure (paragraphs 11-16);

      (i) Recognition (paragraphs 13-16);

   (c) Applying IAS 38 to exploration and evaluation expenditure (paragraphs 17-38);

(i) Recognition (paragraphs 19-36);

(ii) Feedback from additional outreach (paragraphs 37-38);

(d) Appendix A—Comparison of requirements of IFRS 6, IAS 16 and IAS 38;

(e) Appendix B—Extract from IFRS 6.

Scope of research

4. IFRS 6 applies only to exploration and evaluation expenditures—ie expenditures incurred by an entity in connection with the search for mineral resources including minerals, oil, natural gas and similar non-regenerative resources. It does not address any other aspects of accounting by entities engaged in extractive activities. IFRS 6 does not apply to expenditures incurred:[1]

   (a) before the exploration and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area; and

   (b) after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

5. The purpose of this analysis is to explain the accounting treatment for those expenditures currently accounted for applying IFRS 6 as if IFRS 6 and the scope exclusions for the recognition and measurement of exploration and evaluation assets in IAS 16 and IAS 38 did not exist. The analysis does not consider extractive activities outside the scope of IFRS 6 such as development and production.

6. Appendix A to this paper includes a table comparing the requirements of IFRS 6 with IAS 16 and IAS 38.

Assumptions applied

7. There is a common sequence of activities undertaken by entities engaged in extractive activities. These activities usually start with the acquisition of legal rights to explore a defined area. Exploration and evaluation activities produce information about the

[1] See paragraphs 3-5 of IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

geology and the presence and extent of any mineral or oil and gas deposit. Over time, the exploration will increase the understanding of the mineral or oil and gas deposit to the point at which an assessment can be made of whether there is a mineral or oil and gas deposit that can be economically developed.[2] Consequently, the staff have grouped exploration and evaluation expenditures into two broad categories being expenditures in connection with:

(a) legal rights—various types of legal instruments that convey the legal rights that permit an entity to undertake exploration and evaluation activities; and

(b) information—information about the property obtained through exploration and evaluation activities (such as those described in Appendix B), which may include information about the existence of minerals or oil and gas, the extent and characteristics of the deposit, and the economics of their extraction.[3]

8. This paper focuses on an entity undertaking a common sequence of activities as described in paragraph 7. It does not address the circumstance of subsequent exploration and evaluation expenditure on an acquired in-process exploration and evaluation project.

9. It is important to note that stakeholders continue to have differing views about whether the cost of exploration and evaluation activities meets the definition of an asset applying the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*), and if so, whether an asset should be recognised (see ***September 2019 Agenda Paper 19C***). The ***September 2019 Agenda Paper 19C*** does not conclude whether the cost of exploration and evaluation activities meets the definition of an asset that should be recognised applying the *Conceptual Framework*. For the purpose of this paper, the staff have assumed that the exploration and evaluation expenditure, as defined in paragraph 7, could give rise to an asset applying the *Conceptual Framework*. However, recognising the cost of such activities as assets would be appropriate only if the recognition of such assets provides primary users with useful

[2] See paragraph 3.12 of the 2010 *Extractive Activities* Discussion Paper.

[3] We have not specifically considered the implications of the scope in paragraph 5 on fixed assets that are dedicated for use for exploration and evaluation activities (for example, drilling rigs).

information (ie relevant information that provides a faithful representation of what it purports to represent).

10. It is also important to note that stakeholders continue to have differing views about whether an exploration and evaluation asset should be classified as a ‘tangible’ or ‘intangible’. This paper does not conclude on this matter. Instead, the paper considers:

    (a) how IAS 16 would apply to exploration and evaluation expenditure if the expenditure was considered to give rise to an item of ‘tangible’ property, plant and equipment; and

    (b) how IAS 38 would apply to exploration and evaluation expenditure if the expenditure was considered to give rise to an ‘intangible’ asset.

Applying IAS 16 to exploration and evaluation expenditure

11. Paragraph 9 of IAS 16 states that:

> Property, plant and equipment are tangible items that:
>
> (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
>
> (b) are expected to be used during more than one period.

12. In the absence of IFRS 6 and the IAS 16 scope exclusions, those stakeholders that would argue that exploration and evaluation assets meet the definition of property, plant and equipment might do so because the legal rights[4] and information can be:

    (a) tangible—for example, a legal right, and the information associated with that legal right, provides access and relates to a mineral or oil and gas deposit that is tangible (physical) in nature and the subsequent expenditure could also result in a physical asset, for example, an exploration well;

    (b) held for use in the production of minerals or oil and gas—for example, the legal right could include a right for the entity to extract minerals or oil and

[4] Although paragraph 16 of IFRS 6 suggests that drilling rights might be intangible assets, for completeness we have also considered these under IAS 16 *Property, Plant and Equipment*.

gas and the information can be used to determine the method of extraction (ie production of goods);

(c) expected to be used during more than one period—for example, the legal right can extend over several reporting periods and provide access to the mineral deposit for that extended period.

Recognition

13. Paragraph 7 of IAS 16 states that:

> The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:
>
> (a) it is probable that future economic benefits associated with the item will flow to the entity; and
>
> (b) the cost of the item can be reliably measured.

Probability of future economic benefits

14. The staff think that exploration and evaluation assets do not meet the recognition criteria in paragraph 7 of IAS 16. Although it is possible to reliably measure the cost of such assets (see ***September 2019 Agenda Paper 19C***), the staff think the criteria in paragraph 7(a) of IAS 16 would not be met during the exploration and evaluation phase of extractive activities.

15. In line with the staff analysis discussed at the Board's September 2019 meeting (see ***September 2019 Agenda Paper 19C***), although the *potential* for future economic benefits exists, the *probability* of future economic benefits is low. This is because mineral or oil and gas exploration and evaluation has a low probability of success (success being, for example, that the deposit can be commercially mined). For example, an entity would not be able to reliably determine the probability of future economic benefits until technical feasibility and commercial viability has been determined. At that point, if it is probable that future economic benefits will flow to the entity, then the entity will be nearing completion of, or will have completed, its exploration and evaluation activities.

16. Therefore, the staff think that at the point at which future economic benefits are probable, the entity is no longer undertaking exploration and evaluation activities. Consequently, we think that it is likely that exploration and evaluation expenditure would be recognised as an expense as incurred if IAS 16 were applied.

Applying IAS 38 to exploration and evaluation expenditure

17. Paragraph 8 of IAS 38 defines an intangible asset as:

> …an identifiable non-monetary asset without physical substance.

18. In the absence of IFRS 6 and the IAS 38 scope exclusions, those stakeholders who would argue that exploration and evaluation assets should be classified as an 'intangible' asset, would consider the legal rights to explore and the information that exploration and evaluation expenditure generates to be intangible in nature, without physical substance.

Recognition

19. Paragraph 18 of IAS 38 states that:

> The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
>
> (a) the definition of an intangible asset; and
>
> (b) the recognition criteria.

20. Paragraph 10 of IAS 38 explains that to meet the definition of an intangible asset, the asset must be identifiable, the entity must have control over the resource and there must be the existence of future economic benefits.

21. The staff think that legal rights and information could meet the requirements of paragraph 10 of IAS 38, and therefore paragraph 18(a) of IAS 38, because the legal rights and associated information:

(a) are identifiable—legal rights and the associated information arise from contractual or other legal rights;[5]

(b) can be controlled by the entity—the entity has the power to obtain future economic benefits flowing from the legal rights and information and restrict the access of others to those benefits;[6] and

(c) have the potential to produce future economic benefits—in line with the staff analysis discussed at the Board's September 2019 meeting (see ***September 2019 Agenda Paper 19C***) the legal rights and information have the potential to produce economic benefits.

22. Paragraph 21 of IAS 38 states that:

> An intangible asset shall be recognised if, and only if:
>
> (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and
>
> (b) the cost of the asset can be measured reliably.

Probability of future economic benefits

23. The staff think that exploration and evaluation assets do not meet the recognition criteria in paragraph 21 of IAS 38. Similar to the findings in paragraphs 14-16 of this paper, although it is possible to reliably measure the cost of such expenditure (see ***September 2019 Agenda Paper 19C***), we think the criteria in paragraph 21(a) of IAS 38 would not be met during the exploration and evaluation phase of extractive activities. This is because, although exploration and evaluation expenditure is incurred to generate future economic benefits, the probability of those expected future economic benefits is low.

Separate acquisition

24. Paragraphs 25 and 26 of IAS 38 state:

[5] See paragraph 12(b) of IAS 38 *Intangible Assets*.

[6] See paragraph 13 of IAS 38.

> 25 Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.
>
> 26 In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

25. Exploration and evaluation expenditure incurred acquiring the legal rights from a third party could therefore meet the definition of an intangible asset and the recognition criteria, because the probability recognition criteria would be considered to be met in accordance with paragraph 25 of IAS 38.[7]

26. However, as explained in BC36 of the Basis for Conclusions on IFRS 6, applying IAS 36 *Impairment of Assets* without the specific requirements in paragraphs 18-22 of IFRS 6 would generally lead to an immediate write-off of exploration and evaluation assets. In many cases exploration and evaluation assets do not generate cash flows and there is insufficient information about the mineral resources in a specific area for an entity to make reasonable estimates of exploration and evaluation assets' recoverable amounts. This is because the exploration for and evaluation of the mineral resources has not reached a stage at which information sufficient to estimate future cash flows is available to the entity. Without such information, it is not possible to estimate either fair value less costs of disposal or value in use, the two measures of recoverable amount in IAS 36.

[7] Some might view the exploration and evaluation expenditure incurred subsequent to the acquisition of the legal right as an enhancement of the legal right asset. However, paragraph 18 of IAS 38 requires the recognition criteria in IAS 38 to apply to the expenditure incurred to add to, replace part of, or service the initially recognised asset. Hence, the subsequently incurred expenditure would still fail to meet the recognition criteria as discussed in paragraph 23.

27. Therefore, despite the requirements in paragraphs 25 and 26 of IAS 38, the staff think it is possible that the legal right asset might be immediately written-off. However, the staff have not considered whether an active market might exist for legal rights or whether an expected cash flow approach to measure value in use (see Appendix A of IAS 36) might result in a recoverable amount that is higher than the cost of the legal right.

Research versus development phases

28. Some stakeholders responding to the Board's 2010 Discussion Paper *Extractive Activities* and a few users of financial statements in the Board's earlier outreach (see ***September 2019 Agenda Paper 19A***), thought that exploration and evaluation activities are broadly similar to activities undertaken in other industries, such as research and development activities in the pharmaceutical and high-technology industries.

29. These stakeholders questioned whether exploration and evaluation expenditure incurred subsequent to the acquisition of legal rights should be treated similarly to research and development expenditure applying IAS 38.

30. Paragraph 51 of IAS 38 states:

> It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:
>
> (a) identifying whether and when there is an identifiable asset that will generate future economic benefits; and
>
> (b) determining the cost of the asst reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations…

31. Paragraphs 52 of IAS 38 states:

> To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:

(a) a research phase; and

(b) a development phase.

…

32. Paragraphs 54 and 55 of IAS 38 state:

54 No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

55 In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.

33. Paragraph 56 of IAS 38 lists examples of research activities:

…

(a) activities aimed at obtaining new knowledge;

(b) the search for, evaluation and final selection of, applications of research findings or other knowledge;

(c) the search for alternatives for materials, devices, products, processes, systems or services; and

(d) the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

34. Paragraph 57 states:

An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.

(b) its intention to complete the intangible asset and use or sell it.

(c) its ability to use or sell the intangible asset.

(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.

(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

35. Staff think exploration and evaluation expenditure incurred subsequent to acquiring the legal right would be most similar to expenditure incurred during the 'research phase' as described in IAS 38. This is because:

(a) an entity would be unable to meet the recognition criteria listed in paragraph 57 of IAS 38 during the exploration and evaluation phase—for example, once an entity is able to demonstrate technical feasibility of a project, expenditure incurred is no longer within the scope of exploration and evaluation activities (see paragraph 4); and

(b) applying paragraph 55 of IAS 38 and the staff analysis in paragraphs 14-16 and 23, an entity would be unable to demonstrate that an intangible asset exists that will generate probable future economic benefits during the exploration and evaluation phase.

36. Therefore, applying the guidance in paragraphs 54 and 55 of IAS 38, exploration and evaluation expenditure incurred subsequent to the acquisition of the legal right would be recognised as an expense as it is incurred, in line with what was concluded in paragraph 23.

Feedback from additional outreach

37. At its June 2020 meeting, the Board considered the feedback from additional outreach activities with jurisdictions that also have significant extractive activities (see ***June 2020 Agenda Paper 19A***). Although the staff did not ask participants in the outreach a specific question about the application of IAS 38 to exploration and evaluation expenditure, a few stakeholders provided feedback on whether, in their view, the existing requirements in IAS 38 could be applied to exploration and evaluation expenditure.

38. These respondents stated that, in their view, the Board should not consider, as part of the scope of its research project, applying IAS 38 to such expenditure. In their view, there are significant differences between exploration and evaluation expenditure and expenditure incurred in the research and development phases defined in IAS 38. In particular, these respondents stated that exploration and evaluation expenditure differs from research and development expenditure in the following ways:

    (a) there is no correlation between the cost of capitalised exploration and evaluation expenditure and the value of the mineral or oil and gas deposit—for example, a pharmaceuticals entity can recover the cost of their research and development phases as they are able to set their own price;

    (b) the segmentation of the extractives industry differs from a typical research and development industry in that the extractives industry is dominated by a limited number of large entities engaged in all extractive activities and many small entities engaged in exploration and evaluation activities only;

    (c) recovery of the cost of exploration and evaluation expenditure can occur only through exploitation or sale of the mineral or oil and gas property;

    (d) some stock exchanges have specific requirements to disclose publicly the results of exploration and evaluation activities;

    (e) entities with extractive activities will share expenditures to reduce risk during the exploration and evaluation phase—for example, by engaging in a risk-sharing agreement or farm-out agreement; and

(f) when successful, exploration and evaluation expenditure results in a tangible asset, the mineral deposit, whereas research and development results in an intangible asset, knowledge.

Appendix A—Comparison of requirements of IFRS 6, IAS 16 and IAS 38

	IFRS 6	IAS 16	IAS 38
Initial recognition	• Required to apply paragraph 10 of IAS 8 to develop the most appropriate accounting policy for recognition (paragraphs 6-7)	• Definition of property, plant and equipment (paragraph 6) • Recognition criteria (paragraph 7): (a) probable that future economic benefits related to the asset will flow to the entity; and (b) cost can be reliably measured.	• Definition of intangible asset (paragraph 8-17) • Recognition criteria (paragraphs 21-23): (a) probable that future economic benefits related to the asset will flow to the entity; and (b) cost can be reliably measured.
Measurement at initial recognition	• Measured at cost (paragraph 8) • Guidance about elements of cost of exploration and evaluation assets (paragraphs 9-11)	• Measured at cost (paragraph 15) • Guidance about elements of cost (paragraphs 16-22A)	• Measured at cost (paragraph 24) • Internally generated intangible assets from the research phase are expensed as incurred (paragraphs 54-56) • Internally generated intangible assets from the development phase can only be recognised when the recognition criteria are met (paragraphs 57-64)

	IFRS 6	IAS 16	IAS 38
Subsequent measurement	• Choice between cost or revaluation models (paragraph 12) • Exploration and evaluation assets are not subject to depreciation or amortisation	• Choice between cost or revaluation models (paragraph 29) • Property, plant and equipment are subject to depreciation (paragraphs 43-62A)	• Choice between cost or revaluation models (paragraph 72) • Intangible assets with finite useful lives are subject to amortisation (paragraphs 97-106) • Intangible assets with indefinite lives are not subject to amortisation (paragraph 107)
Impairment	• For the purposes of exploration and evaluation assets only, paragraph 20 of IFRS 6 shall be applied rather paragraphs 8-17 of IAS 36 when identifying an exploration and evaluation asset that may be impaired (paragraphs 18-20) • An entity shall determine a policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units (paragraphs 21-22)	• Required to apply IAS 36 with no modifications (paragraph 63)	• Required to apply IAS 36 with no modifications (paragraph 111)

	IFRS 6	IAS 16	IAS 38
Derecognition	• No requirements for derecognition of exploration and evaluation assets	• Asset is required to be derecognised (paragraph 67): (a) on disposal; or (b) when no future economic benefits are expected from its use or disposal	• Intangible asset required to be derecognised (paragraph 112): (a) on disposal; or (b) when no future economic benefits are expected from its use or disposal

Appendix B—Extract from IFRS 6

…

Elements of cost of exploration and evaluation assets

9 An entity shall determine an accounting policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources. The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

(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.

10 Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. The *Conceptual Framework for Financial Reporting* and IAS 38 *Intangible Assets* provide guidance on the recognition of assets arising from development.

11 In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.

…