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Mr Cohn Fleming
International Accounting Standards Board
30 Cannon Street
London
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Dear Mr Fleming

Exposure draft 6, 'Exploration for and evaluation of mineral resources', ('ED 6')

With a membership in excess of 37,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies that form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in professional services practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise consultation papers and make representations to issuing bodies.

We welcome the opportunity to comment on IASB's Exposure Draft 6 and our Technical Committee has considered the proposals in it. We broadly support the objectives of the Exposure Draft, and in particular the need for an interim measure ahead of 2005, given that exploration for and evaluation of mineral resources are currently excluded from the scope of IFRSs. The proposals however do nothing to enhance comparability between entities engaged in such activities. We therefore consider the need for a comprehensive project on accounting and financial reporting issues for extractive industries to be no less pressing following publication of a standard based on ED 6. We emphasise the point, made by the IASB, that the proposals contained within ED 6 represent a 'temporary measure' and urge upon the Board the need to press ahead with the longer-term project as a top priority.

We understand that the accounting proposed in ED 6 is largely consistent with practice already followed by UK companies, be it 'full cost' method or 'successful efforts' method. We believe that any major changes to current practice should be encompassed in the comprehensive project and not addressed as part of this interim measure. We set out in the attached our Committee's response to your specific questions where we have highlighted those areas that we understand represent a major change to current practice, and therefore conflict with the agreed objectives of the proposed standard.

If you would like to discuss anything in this response, please contact me at the above address, or call Helen McCallion on 020 7804 6235.

Yours faithfully

Margaret Cassidy

Margaret Cassidy
Chairman, LSCA Technical Committee

Question 1 - Definition and additional guidance

The proposed IFRS includes definitions of exploration for and evaluation of mineral resources, exploration and evaluation expenditures, exploration and evaluation assets and a cash-generating unit for exploration and evaluation assets. The draft IFRS identifies expenditures that are excluded from the proposed definition of exploration and evaluation assets. Additional guidance is proposed in paragraph 7 to assist in identifying exploration and evaluation expenditures that are included in the definition of an exploration and evaluation asset (proposed paragraphs 7 and 8, Appendix A and paragraphs BC12-BC14 of the Basis for Conclusions).

We believe that the proposed definition of ‘exploration for and evaluation of mineral resources’ is adequate. However, we believe it would be helpful to expand upon the additional guidance proposed in paragraph 7, using some of the guidance included in the IASC’s Issues Paper on extractive industries (‘Issues Paper’), published in November 2000. Currently paragraph 7 of ED 6 provides examples of types of expenditure that may be included in the initial measurement of exploration and evaluation assets. However some of the examples given can potentially fall outside the definition of exploration for and evaluation of mineral resources. For example further exploration work, such as trenching and sampling, may also be carried out during the development phase of a project, to learn more about the quality and quantity of the mineral resource. Users may concentrate unduly on the examples provided in paragraph 7 of ED 6 to the exclusion of the overriding definition of exploration for and evaluation of mineral resources. The Issues Paper sets out and explains the typical upstream activities of the exploration and evaluation phase, which appear to be prospecting, acquisition of mineral rights, exploration, and appraisal or evaluation. It then goes on to provide examples of the types of expenditures that would typically fall under each of these activities. Amendment of paragraph 7 to incorporate the relevant guidance in the Issues Paper would improve users’ understanding of the types of expenditure that can be included in initial measurement of exploration and evaluation assets, lessening the scope for differing interpretations. It would also help clarify whether ‘pre-exploration’ or ‘prospecting’ costs are included in the definition of ‘exploration for and evaluation of mineral resources’.

Paragraph 8(b) of ED 6 states that administration and other general overhead costs shall not be included in the initial measurement of exploration and evaluation assets. IAS 16, ‘Property, plant and equipment’, states that the cost of an item of property, plant and equipment comprises ‘any costs *directly attributable* to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.’ (IAS 16, para 16(b)). The UK’s Statement of Recommended Practice on ‘Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities’, ('OIAC SORP’) requires only those administrative and general overhead costs ‘not directly attributable’ to exploration activities to be expensed as incurred for those companies using either the full cost method or successful efforts method. (SORP paras 42 and 55). We believe paragraph 8(b) of ED 6 should be amended to include in initial measurement ‘directly attributable’ administration and other general overhead costs. This would bring the proposed standard in line with LAS 16 and with the objectives set out in 1(a) of the proposed standard.

Question 2 - Method of accounting for exploration for and evaluation of mineral resources

(a) **Paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify sources of authoritative requirements and guidance an entity should consider in developing an accounting policy for an item if no IFRS applies specifically to that item. The proposals in the draft IFRS would exempt an entity from considering the sources in paragraphs 11 and 12 when assessing its existing accounting policies for exploration and evaluation expenditures by permitting an alternative treatment for the recognition and measurement of exploration and evaluation assets. In particular, the draft IFRS would permit an entity to continue to account for exploration and evaluation assets in accordance with the accounting policies applied in its most recent annual financial statements.**

(b) **The Exposure Draft proposes that an entity would continue to use its existing accounting policies in subsequent periods unless and until the entity changes its accounting policies in accordance with IAS 8 or the IASB issues new or revised Standards that encompass such activities (proposed paragraph 4 and paragraphs BC8-BC11 of the Basis for Conclusions).**

Are these proposals appropriate? If not, why not?

As noted in our covering letter we believe these proposals are appropriate. The proposals intend to allow companies to continue with their existing accounting policies on recognition and measurement of exploration and evaluation assets — pending completion of a comprehensive project in this area. It also emphasises the need for companies engaged in these activities to consider carefully the appropriateness of a change in accounting policy on transition to IFRS, providing clarity in the interim period.

We are concerned that the structure of the proposed standard is confusing. The key 'temporary exemption from some other IFRSs', relating to both recognition and 'measurement', is included under a heading entitled '*Recognition* of exploration and evaluation assets'. Separate sections then follow on *measurement* and *impairment.* As a result it is unclear whether the sections on measurement and impairment apply when the temporary exemption is taken. It is also unclear which parts of the proposed standard apply when the temporary exemption is not taken. We believe that the present structure of the proposed standard could lead to potentially differing interpretations if finalised in its current form. We recommend the IFRS be restructured with the inclusion of clear guidance on the recognition, measurement and disclosure implications of taking, and of not taking, the temporary exemption.

Question 3 - Cash-generating units for exploration and evaluation assets

[Draft] IAS 36[1] requires entities to test non-current assets for impairment. The draft IFRS would permit an entity that has recognised exploration and evaluation assets to test them for impairment on the basis of a 'cash-generating unit for exploration and evaluation assets' rather than the cash-generating unit that might otherwise be required by [draft] IAS 36. This cash-generating unit for exploration and evaluation assets is used only to test for impairment exploration

and evaluation assets recognised under proposed paragraph 4 (see proposed paragraphs 12 and 14 and paragraphs BC15-BC23 of the Basis for Conclusions).

Are the proposals appropriate? If not, why not? If you disagree with the proposal that exploration and evaluation assets should be subject to an impairment test under [draft] IAS 36, what criteria should be used to assess the recoverability of the carrying amount of exploration and evaluation assets?

We find the guidance in paragraph 12— 14 of the proposed standard unclear and slightly contradictory. Paragraph 12 appears to require annual impairment tests whereas paragraph 13 goes on to provide a list of impairment indicators. If annual impairment tests are required by the proposed standard then why the need for further clarity on impairment indicators. The inclusion of tailored indicators infers that IAS 36 would be applied as for any finite life asset, i.e. that will review for impairment when indicators exist. If the proposed standard does require annual impairment tests it should state this in a clear and unambiguous statement and set the list of impairment indicators in paragraph 13 within this context. We do not agree that a full annual impairment review in accordance with IAS 36, in the absence of any impairment indicators, is necessary and are concerned that this requirement would represent a major change from existing practice.

Once the Board's position is clarified, consideration should be given as to whether a consequential amendment to IFRS 1, 'First time adoption of international financial reporting standards' is required. For example, if annual impairment tests are required, should an impairment review be carried out at the date of transition, at the comparative period reporting date and at the reporting date, on first time adoption of IFRS? It would currently appear so under IFRS 1.

It should also be made clear, either in paragraph 12 of the proposed standard, or in paragraph 16, that the disclosure requirements of IAS 36 are required, in addition to those disclosures specifically required by proposed standard. Currently this point is only made in the Basis for Conclusions, at paragraph BC 35.

Question 4 - Identifying exploration and evaluation assets that may be impaired

The draft IFRS identifies indicators of impairment for exploration and evaluation assets. These indicators would be among the external and internal sources of information in paragraphs 9-13 of [draft] IAS 36 that an entity would consider when identifying whether such assets might be impaired (paragraph 13 and paragraphs BC24-BC26 of the Basis for Conclusions).

Are these indicators of impairment for exploration and evaluation assets appropriate? If not, why not? If you are of the view that additional or different indicators should be used in assessing whether such assets might be impaired, what indicators should be used and why?

Please see our response to question 3 above, which suggests that these indicators are placed in the context of IAS 36 as applied within the proposed standard.

The impairment indicators in paragraph 13 provide useful specific guidance. We are concerned however that the impairment indicator at paragraph 13 (f) could be onerous, particularly where an area has been recently acquired. We believe the impairment indicator at 13(f), 'the entity does not expect the recognised exploration and evaluation assets to be reasonably capable of being recoverable from a successful development of the specific area, or by its sale', should be amended to include the following at the end of the current proposed wording, 'within a reasonable time period and following additional appraisal activity'.

Question 5 - Disclosure

To enhance comparability, the draft IFRS proposes to require entities to disclose information that identifies and explains the amounts in its financial statements that arise from the exploration for and evaluation of mineral resources (proposed paragraphs 15 and 16 and paragraphs BC32-BC34 of the Basis for Conclusions).

Are the proposed disclosures appropriate? If not, why not? Should additional disclosures be required? If so, what are they and why should they be required?

Please see our response to question 3 above where we suggest that the proposed standard makes clear that the disclosures required by IAS 36 must be made, in addition to those specifically required by the proposed standard. Furthermore the Board notes in its Basis for Conclusions, paragraph BC35, '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'. We recommend that this is made clear within the IFRS itself. Our concern being that entities may view the absence of detailed disclosure requirements within the IFRS as justification for dropping some of the useful disclosures currently made under their existing policies.

We do agree with the inclusion of the additional disclosures required by the proposed standard.