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28 May 2004

The Institute of Chartered Accountants in Australia

Colin Fleming
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Dear Colin

ED 6 'Exploration for and Evaluation of Mineral Resources': Unacceptable for Australia

The Institute of Chartered Accountants in Australia ('the Institute') hereby requests that the proposals of ED 6 be made subject to the existing requirements in jurisdictions that currently apply a comprehensive Standard for the extractive industries.

As you are no doubt aware, Australian accounting standards will be converged with international accounting standards from 1 January 2005. In this context, it is vital that Australian mining companies have certainty about accounting for exploration and evaluation activities as soon as possible.

ED 6 in its current form is in breach of the objects of Part 12 of the *Australian Securities and Investments Commission Act 2001* and as such could not be adopted by the Australian Accounting Standards Board. The appendix to this letter illustrates how the proposals of ED 6 would diminish the comparability of financial information relative to existing Australian GAAP.

ED 6 needs substantial amendment if it is to qualify for adoption in Australia. Ideally, the IASB must issue a comprehensive International Standard (akin to AASB 1022) that deals with all the issues of accounting for the extractive industries. In the meantime, any stopgap measure to impose the impairment model on this particular class of non-current assets must be subject to the specific requirements in those jurisdictions that already have a comprehensive Standard.

The Institute is determined that a due process must accompany any fundamental changes to accounting for the extractive industries in Australia.

Yours sincerely

Jeffrey John Knapp

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c.c. Warren McGregor, Member, International Accounting Standards Board
David Boymal, Chairman, Australian Accounting Standards Board

APPENDIX – COMPARISON OF AASB 1022 AND ED 6

The purpose of this appendix is to compare the position of accounting for the exploration and evaluation expenditures based on the existing Australian GAAP and the proposals in ED 6. The comparison considers three categories of entity, namely, a miner that has already reached the production stage, an explorer that already has existing accounting policies and an explorer that has just commenced operations.

The stark conclusion that can be drawn from this comparison is that the proposals of ED 6 would replace the comparable financial information that results from the application of AASB 1022 with uncertainty and non-comparable financial information.

AASB 1022 Accounting for the Extractive Industries

Accounting/Entity	*Mature Producer*	*Explorer (existing)*	*Explorer (new)*
Initial recognition	Asset	Asset	Asset
Initial measurement	Cost	Cost	Cost
Subsequent measurement	Cost model or fair value model	Cost model or fair value model	Cost or fair value model
Systematic amortisation	Costs allocated using production units method	Costs allocated using production units method	Costs allocated using production units method
Amortisation of costs included in inventory	Yes	Yes	Yes
Impairment	Recoverable amount test based on area of interest	Recoverable amount test based on area of interest	Recoverable amount test based on area of interest

ED 6 Exploration and Evaluation of Mineral Resources

Accounting/Entity	*Mature Producer*	*Explorer (existing)*	*Explorer (new)*
Initial recognition	Asset	Asset	Expense
Initial measurement	Cost	Cost	N/A
Subsequent measurement	Cost model or fair value model	Cost model or fair value model	N/A
Systematic amortisation	No guidance – leading to various	No guidance – leading to various	N/A
Amortisation of costs included in inventory	No guidance – leading to various	No guidance – leading to various	N/A
Impairment	CGU (IAS 36) or CGU based on area of interest not greater than a segment	No CGU rather a naked test of the Ex and Ev expenditures	N/A

Additional Commentary

Initial recognition

AASB 1022 requires that the recognition of exploration and evaluation costs must be assessed on an area of interest basis (clause .10). AASB 1022 requires that exploration and evaluation costs may be capitalized as an asset where there are current rights of tenure and the costs are expected to be recouped or it is not possible to make a determination about recoupment at this stage (clause.11).

ED 6 allows an entity with an existing accounting policy for asset recognition to continue that policy (paragraph 4). By construction, ED 6 does not allow newly incorporated companies and entities in equivalent situations to grandfather the asset recognition criteria in AASB 1022. Therefore new explorers will be subject to the hierarchy in Pending AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors, which some interpret as immediate expense recognition. In these circumstances new explorers would be preparing financial reports on a completely different basis to existing explorers and producers.

Systematic amortisation

AASB 1022 requires systematic amortisation of deferred costs over the life of the area of interest based on production output and economically recoverable reserves with annual reassessment (clauses .31 and .32). ED 6 is silent on whether deferred costs should be systematically amortised and no other International Standards are applicable to the question.

Amortisation of costs included in inventory

AASB 1022 requires that amortisation charges must be included in the costs of production of inventory (clause .32). ED 6 is silent on this question.

Impairment

The generic recoverable amount test in AASB 1010 Recoverable Amount of Non-Current Assets is applicable to deferred exploration and evaluation costs but is subject to the specific capitalisation criteria in AASB 1022 that allows capitalisation to continue until such time that the economics of the area of interest are readily apparent. By contrast, ED 6 forces the recoverable amount test on all deferred exploration and evaluation expenditure carried forward.

Existing explorers will not be able to use the CGU definitions because their assets have not reached the point of being cash generating. The exploration and evaluation costs of existing explorers will be naked to the recoverable amount test. The application of present value techniques will most likely lead to impairment writedowns on tenements that have not been proved up whereas previously the costs incurred on these tenements could be carried forward.

ED 6 has a non-writedown bias towards producers over existing explorers and new explorers. Existing producers are able to choose between two models of aggregating assets for the application of the impairment test. In particular, producers will be able to maintain their existing area of interest framework for impairment testing provided the area generates cash and is no larger than a segment. The ability to aggregate to a relatively high level means that producers will not have to write off exploration and evaluation costs in otherwise identical circumstances to existing explorers or new explorers.

Final Comment

ED 6 ignores the initial recognition criteria for deferred exploration and evaluation costs but deals with initial measurement. It allows subsequent measurement of the deferred costs at fair value without considering the consequences of this option for inventory valuation. It ignores the systematic amortisation of deferred costs based on production while overlaying an impairment model. It sets out appropriate and useful indicators of impairment for the deferred costs but then cheapens them by making annual impairment testing mandatory. Worst of all, ED 6 assumes that users can simply make up accounting policies in the extractive industries using the Framework and the requirements in IAS 38 Intangible Assets. It is incomprehensible that the IASB should delegate this exercise to users in circumstances where it has not been able to complete the exercise itself.

The Institute view is that the IASB cannot take a "half-pregnant" approach to accounting for the extractive industries for 2005. The IASB must issue a Standard that is comprehensive and consistent with the Framework/IFRS. In the meantime, the existing comprehensive GAAP in jurisdictions for exploration and evaluation costs must be allowed to take precedence.