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International Accounting Standards Board
30 Cannon Street,
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26 April 2004
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Dear Sirs

ED 6, Exploration for and Evaluation of Mineral Resources

Danish Institute of State Authorised Public Accountants (FSR) welcomes the opportunity to provide comments on the International Accounting Standards Board's (the Board's or IASB's) Exposure Draft – ED 6 *Exploration for and Evaluation of Mineral Resources* (referred to as ED 6 or the draft standard).

FSR's Accounting Standards Committee has reviewed the ED and our responses to the questions raised in the Exposure Draft and comments on specific matters of concern are set out in the Appendix to this letter.

The topic that ED 6 covers will impact only a limited number of companies in Denmark. Therefore, the topic is not very known in Denmark. There are thus only a few groups in the oil and gas industry in Denmark that will be within the scope of the standard. Therefore our experience in relation to the topic only relates to this industry.

General comments

Generally we are supportive of the objectives of ED 6 *"to provide guidance on the treatment of exploration and evaluation expenditures that will enhance comparability between entities while avoiding unnecessary disruption to the application of those treatments, pending more complete consideration on the accounting issues involved"*.

We understand the importance of IASB adressing the issue of how to account for exploration and evaluation prior to the implementation of International Financial Reporting Standards (IFRS) in Europe. We also understand that a comprehensive project involving the development of proper recognition and measurement principles for the extractive industries will not be ready for the Europe 2005 companies. Therefore, we understand that time constraints permits only for some interim guidance on the accounting for exploration for and evaluation of mineral resources. We do however urge the Board to complete a comprehensive project as soon as possible to limit the interim period.

In our opinion the limited improvements would not necessarily improve comparability between entities across the industry because under ED 6, companies would be permitted to continue with their existing accounting practices. It is not quite clear how allowing entities to continue with their current accounting policies, whatever they might be, can “enhance comparability.”

On the other hand, requiring entities to look to IAS 8, paragraphs 11 and 12 in the absence of a standard, would force companies to look at the Framework and also allow them to look at “accepted industry practice.” We believe this would force management to challenge their existing policies, change policies that clearly violate the Framework and are not supported by industry practice, leading to modestly better comparability until the comprehensive project is completed.

We understand that there is clearly an existing industry practice in both the Oil and Gas and Mining industries of capitalising exploration and evaluation expenditure, followed by many (but not all) companies. The intent of the IASB seems to be to allow those companies that capitalise now to continue doing so pending further study in a comprehensive project. Under IAS 8 such capitalisation seems possible unless application of similar Standards and Interpretations (IAS 8.11(a)) or the Framework (IAS 8.11(b)). IAS 38 would seem to be the only standard dealing with “similar and related issues” in this respect. The IASB may consider whether it could achieve the ED 6 objectives by asking IFRIC to issue an Interpretation of IAS 8 for the extractive industries stating that IAS 38 is not considered “similar and related” for this purpose. We also believe companies should be required to look at the Framework (and industry practice) to consider whether costs they are proposing to capitalise, qualify as an asset. If companies are to state compliance with IFRS it seems entirely wrong to ignore the Framework

Appendix 1 sets out our answers to the questions raised in the draft Standard.

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If you have questions to the above, please do not hesitate to contact us.

Yours sincerely

Eskild Nørregaard Jakobsen
Chairman of FSR’s Accounting
Standards Committee

Ole Steen Jørgensen
Head of Department

Appendix 1

ED 6, Exploration for and Evaluation of Mineral Resources

<u>Question 1</u>: 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 excluded 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).

In our opinion the definition is too wide and does not distinguish between exploration and pre-exploration costs, as it was done in the issues paper published by the IASC in 2000.

The wording and the examples in paragraph 7 are not very clear and leave room for interpretation.

<u>Question 2</u>: 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?

Bearing in mind our comments in the cover letter we agree that the proposals are appropriate.

However, we do find the Exposure Draft very confusing in the description of the two approaches.

In paragraph 4 it is stated that the entity may elect to continue to recognise *and measure* exploration and evaluation assets in accordance with the accounting policies it applied in its most recent annual financial statements, except as provided in paragraph 8. Paragraphs 6-10 only contain measurement requirements (and no recognition requirements) but it is not specified in which cases they apply. We suppose that paragraphs 6-10 must be intended to be applied by entities that elect to continue to use its accounting policies, while you will be completely out of the standard if you chose not to continue with the current accounting policies.

We suggest that the Board explicitly state the provisions for recognition and measurement for each approach.

<u>Question 3</u>: Cash-generating units for exploration and evaluation assets

[Draft] IAS 36 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 do not think that the proposals are appropriate, as we do not see the need for different rules for testing impairment in an entity that has recognised exploration and evaluation assets. In our opinion the requirement should be in accordance with [draft] IAS 36, including the level of cash-generating unit, to avoid an industry distinction.

We question whether the proposal for a cash-generating unit for exploration and evaluation expenditure is helping the many companies that only do exploration and whose only significant assets are their capitalised exploration expenditure. We would recommend IASB to consider if these companies urgently need an IFRIC Interpretation of IAS 36 providing guidance on how to test their exploration assets for impairment. For companies with both operating mines and exploration activities the proposals seems a logical way to test impairment but, in our view, should be considered in the form of an Interpretation of IAS 36 providing guidance to mining/exploration companies on how they should establish their cash-generating units within the scope of (and not outside) IAS 36.

Under the proposed approach we do find it necessary to accept planned investments and the estimated future cash inflows in relation to those investments in the calculation of the value in use. Otherwise there would often be a need for impairment in the early stages of the exploration activities (i.e. when the exploration activities are not on a full scale).

<u>Question 4</u>: 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?

We find the indicators appropriate.

<u>Question 5</u>: 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?

Yes, but we believe that disclosures similar to the relevant disclosure requirements in IAS 16 *Property, Plant and Equipment* and (draft) IAS 38 *Intangible Assets* should be required.

We also believe that where an entity capitalises exploration and evaluation costs, a reconciliation of the opening balance of amounts capitalised to the closing balance of amounts capitalised should be required.

Furthermore we find that additional disclosures are required to mitigate the negative effects resulting from the continuation of different accounting policies for entities applying IFRS and engaged in extractive and evaluation activities.