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Dear Colin

ED 6 - Exploration and Evaluation of Mineral Resources

Thank you for the opportunity to comment on the exposure draft for Exploration and Evaluation of Mineral Resources. Exposure drafts of this nature help to minimise dissimilar interpretations whilst ensuring the objective of entities achieving transition to IAS is achieved in a timely manner.

We understand that the primary objective of the IASB in issuing ED6 is to establish a specific basis of application of IFRS/IAS for exploration and evaluation activities, with particular respect to asset recognition and the associated impairment testing. The objective sought to provide minimum interruption to existing practice, pending development of a comprehensive accounting standard for the extractive industries. We draw your attention to the need for discussion on the full range of activities in the extractive industries, such as extraction, development, exploration leasing activities, restoration provisioning, product costing, overburden removal etc. We understand that these matters will be fully considered in the IASB's wider extractive industries project over the next couple of years. In the interim however, exclusion from the hierarchy of accounting pronouncements as noted in IAS 8 paragraphs 10 — 12, should be applied through specific reference in the standard or within the basis for conclusions.

We are concerned about the impact the proposals in the exposure drafts might have on entities that start up in between the first time application of IFRS and the completion of the IASB's wider extractive industries project. Such entities may be significantly disadvantaged, as they will not be able to take advantage of the intended exemptions in the exposure draft from IAS 8 and the Framework in relation to their accounting policies for exploration and evaluation expenditure. We believe that determining appropriate accounting policies in accordance with IAS 8 could result in the conclusion that all exploration and evaluation expenditure should be expensed as incurred, and do not believe this is an intended outcome of ED6.

Question 1 - Definition and additional guidance

The proposed IFRS includes definitions of exploration for and evaluation of mineral resources, 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 BC 12 — BC 14 of the Basis for Conclusions). Are these proposals appropriate?

The definitions and guidance provides a reasonable framework for entities to evaluate which items are to be expensed versus capitalised. We understand that further clarification will emerge upon completion of the IASB's wider extractive industries project, when extraction and development are further defined.

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

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 paragraph 11 & 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.
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 lAS 8 or the IASB issues new or revised Standards that encompass such activities (proposed paragraph 4 and paragraphs BC8-BC11 1 of the Basis for Conclusions).

Are these proposals appropriate? If not, why not?

As an interim measure, this is acceptable. Going forward a common standard is required to promote comparability of information, rather than allowing for possible significant differences in measurement and recognition criteria. As implied in our opening comments, the scope of the exclusion is limited to accounting policies relating to exploration and evaluation expenditures. In the absence of considering all issues unique to the extractive industries (such as items that flow on from the accounting for exploration and evaluation expenditure including inventory costing and DD&A charges), we question whether the IASB is comfortable that the scope of the exemption offered will be contained as tightly as anticipated.

Question 3 - 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 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 BCI5-BC23 of the Basis for Conclusions).

Are the proposals appropriate? If not, why not? If you disagree with the proposal that exploration and evaluation costs 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?

The proposals are appropriate, however, would be enhanced by additional definition within appendix A under "cash-generating unit for exploration and evaluation assets". The current definition includes "The smallest identifiable group of assets that together with exploration and evaluation assets, generates cash inflows from continuing use on which impairment tests were performed by an entity under the accounting policies applied in its most recent financial statements ... but no larger than a segment." A segment may not be appropriate where entities have a separately disclosed 'exploration and evaluation' segment or report a separate segment for each mining or oil and gas operation. Such disclosure is not uncommon in the extractive industries, as some entities may manage their businesses with separately reported exploration and evaluation divisions, and only allocate to an operating business segment, when they have identified what, if any, mineral reserves are to be found on the tenement. In such cases, the proposals would permit only the exploration and evaluation activities to be included within the cash-generating unit and accordingly a value in use calculation may not provide meaningful information. An alternative would be to expand the definition to include within the group of assets the effect of those assets that were considered as co-existing in the initial approved commercial evaluation. Example situations include a mine and a smelter, and a multiple pit mining operation (different grades).

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

The draft IFRS identified 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 en entity would consider when identifying whether such assets might be impaired (paragraphs 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?

These indicators are appropriate, except for indicator (f) in paragraph 13 'the entity does not expect the recognized exploration and evaluation assets to be reasonably capable of being recoverable from a successful development of the specific are, or by its sale'.

As written, this indicator could be interpreted to mean that when the entity has yet to form a view about the recoverability of an exploration and evaluation asset, the indicator is triggered. We believe the intent of this trigger is for it not to be activated unless the entity has a reason to believe that recoverability is not probable (less than 50% likelihood). We suggest that this trigger by reworded. One suggestion for rewording would be: 'evidence is available that indicates that the economic performance of an asset is, or will be, worse than expected'.

Question 5 - Disclosure

To enhance comparability, the draft IFRS proposes to require entities to disclose in formation 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, we consider the proposed disclosures are satisfactory.

Further comments on Impairment Testing under IAS 36.

Determining 'value in use' for exploration and evaluation assets

Under IAS 36, in estimating value in use, there is a requirement to estimate the future cash inflows and outflows to be derived from the continuing use of the asset, and to do so on the basis of reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the remaining useful life of the assets. Cash flow projections are to be based on budgets approved by management, that do not exceed five years, or if a longer period is justified, the period beyond five years should be an extrapolation of near term projections. A longer period of projections can be used if management is confident that these cash flows are reliable.

We suggest that the final IFRS resulting from ED 6 clarify that, "due to the size and nature of many mining operations that it will be common in the industry to accept reliance on cash flow projections well in excess of five years as these projections will have been relied upon in making the initial investment decision."

Further, the very prescriptive determination of 'value in use' under the proposed revised IAS 36 may effectively result in a value in use for exploration and evaluation assets that is close to or equal to zero in many cases. This is because future cash flows included in the measurement of value in use must be determined based on the present condition of the assets without reference to future capital expenditure, based on budgets, and so on.

Unless a project is at a very advanced stage, or capitalised exploration can be allocated to other cash-generating units, some might argue that expected cash outflows arising from budgeted exploration and evaluation expenditure should be taken into account when determining value in use, leading to a value in use that may even be negative. It is unclear whether this future expected exploration expenditure could be considered capital expenditure of a type that would be excluded from the value in use calculation under the requirements of IAS 36.

Whilst we do not believe that this outcome is the intention of the exposure drafts, we recommend that this matter be clarified in the final IFRS resulting from ED 6. Ideally, the resultant Standards should include guidance and examples in determining 'value in use' for exploration and evaluation assets, specifically addressing the treatment of future budgeted or expected exploration and evaluation expenditure.

Determining 'fair value' of exploration and evaluation assets

There has been considerable debate as to the nature of exploration and evaluation expenditure and the impacts that this nature has on the determination of 'fair value'. Consideration elements include:

- Some exploration and evaluation does not have a readily determinable 'fair value', as each exploration right is akin to a unique intangible asset whose fair value cannot be determined by reference to the value of other assets.

- Some exploration and evaluation is more akin to a tangible asset, in that within many major mining, and oil and gas areas of the world, there are sufficient exchange transactions occurring and higher levels of prospectivity to allow the determination of fair value.

- Management's cash-flow estimates, which will obviously include future capital expenditure and the resulting flow on effects, could be used to calculate an estimated net selling price. Thus, with respect to future capital spend referred to above, there is an anomaly within the standard with respect to recoverable amount.

We believe that many exploration and evaluation assets do have a readily identifiable fair value, particularly if mineralisation has been identified or the exploration rights are in a prospective area or close to an existing operating mine or field. The determination of the fair value of so-called 'green fields' exploration in relatively unexplored and unknown areas may be more difficult, particularly in the absence of identified prospectivity or indications of potential mineralisation.

We recommend that additional commentary and guidance be included in the final Standards resulting from the exposure draft to clarify that the 'fair value' of exploration and evaluation can be determined and provide examples of the determination of fair value, perhaps by reference to exchange transactions, listed share prices of so-called 'junior explorers' (see below), farm-in agreements, management estimates and other factors.

Using a 'cash generating unit for exploration and evaluation assets'

The exposure draft proposes an option to allow entities on initial adoption of the resultant Standard, to elect to test the impairment of exploration and evaluation on the basis of a 'cash-generating unit for exploration and evaluation assets'.

Under this approach, the carrying amount of exploration and evaluation assets is added to the carrying amount of other cash generating units (CGUs) when performing the impairment test. The CGU must pass the recoverable amount test before and after the inclusion of exploration and evaluation.

As noted above, the value in use of exploration and evaluation assets might often be close to zero, but in many cases the asset may have a fair value on which its recoverable amount could be based. However, the fair value of the CGU to which the exploration and evaluation asset is added may not be readily determinable and it may have been assessed based on a value in use calculation.

To avoid confusion with the interaction of the ‘value in use’ and ‘fair value less costs to sell’ concepts we recommend that the final Standards permit the recoverable amount of a ‘cash generating unit for exploration and evaluation assets’ to be determined as the aggregate of the ‘value in use’ of the underlying CGU and the ‘fair value less costs to sell’ of the exploration and evaluation.

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cc: The Chairman — Australian Accounting Standards Board.