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Subject: Comment Letter - ED 6 Exploration for and Evaluation of Mineral Resources

Dear Sirs,

I am writing you as the Deputy Group Controller of the Royal Dutch/Shell Group ("Shell").

Shell is pleased to have this opportunity to comment on the questions raised in Exposure Draft 6 on Exploration for and Evaluation of Mineral Resources allowing for certain exceptions to various IAS standards until the International Accounting Standards Board has an opportunity to complete a comprehensive project on accounting and financial reporting issues for the extractive industries. Shell agrees that until a comprehensive review of accounting practices used by entities engaged in the exploration for and evaluation of mineral resources is considered, it is appropriate to allow entities to continue with their current accounting. We feel strongly that the suggested changes related to impairment testing would be better suited for the longer-term comprehensive project.

Below you will find our responses to each of the questions presented in the Exposure Draft 6:

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-BC 17 of the Basis for Conclusions).

Response:

The premise of the new statement is to allow an IAS preparer to 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 (current non-IAS GAAP). Therefore, rather than providing a list which may conflict with current non-LAS GAAP, *costs previously considered exploration and evaluation should continue until they are considered in more depth in the IASB comprehensive project for extractive industries. This will also enhance comparability between current and past financial results. Although the Basis for Conclusions mention the Board's desire to have a set definition, it seems a less significant issue to that of allowing a choice of either full costing or successful efforts. Comparability between periods would be more useful to users of financial statements.*

Additionally, the inclusion of the word "may" in paragraph 7 would indicate that these costs were merely suggestive and allow flexibility to follow previous practice. However, the inclusion in paragraph 8 of "shall not" may actually limit some directly related administrative and other general overhead costs that would have been included appropriately under current non-IAS GAAP.

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?

Response:

Yes, these proposals are appropriate. The comment in paragraph BC9 is the most convincing and practical. 'To avoid unnecessary disruption in areas in which it intends to undertake a comprehensive analysis of accounting issues, the Board proposes to limit the need for entities to change their existing accounting practices for exploration and evaluation assets."

As the standard is currently written, it is unclear if future changes to current non-IAS GAAP can be applied between the initial reporting under IFRS as provided by the alternative treatment allowed in ED 6 and the future comprehensive project on extractive industries. Some companies in the industry have read paragraph 11 to state that changes are allowed; whereas others, have taken paragraph 4 to state that changes would not be allowed If changes are made to the current non-IAS GAAP, will an issuer choosing the allowed alternative treatment (current non-IAS GAAP) be able to incorporate these changes and still be in compliance with IFRS?

(Revising of prior GAAP appears to be in order based on the following statements: 1) BC 12. . .An entity may change its accounting policy for exploration and evaluation assets in accordance with the requirements for voluntary changes in accounting policy in IAS 8; and also, 2) IAS 8 paragraph 12—In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-selling bodies that use a similar conceptual framework to develop accounting standard, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.)

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 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 BC 15-BC 23 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 26, what criteria should be used to assess the recoverability of the carrying amount of exploration and evaluation assets?

Response:

The criteria for impairment testing seems to be counter to the purpose of continuing existing accounting policies related to extractive industries. For example, under US GAAP (FAS 19), exploration and evaluation work is capitalised as part of the enterprise 's uncompleted wells, equipment and facilities pending determination of whether the well has found proved reserves. If the well has found proved reserves, the capitalised costs of drilling the well shall become part of the enterprise 's wells and related equipment and facilities; if, however, the well has not found proved reserves, the capitalised costs of drilling the well shall be expensed immediately. US GAAP requires stringent review of assets of this nature that have been held for longer than 12 months before they are classified as a depreciable asset. Until the evaluation work is completed, the measurement of cash flow potential is unreliable in IFRS terms.

The proposed impairment test criteria could allow for exploration costs to be expensed prematurely or not at all depending on the cash generation unit chosen. This does not appear to be the desire of the LASB in issuing this tentative guidance. This would create inconsistency with current non-IAS GAAP; therefore, an IFRS reporter should be able to continue to evaluate costs on the current non-IAS GAAP basis pending further consideration during the comprehensive project.

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 (paragraphs 13 and paragraphs BC 24— BC 26 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?

Response:

Under current non-IAS GAAP many, if not all, of the criteria established by paragraph 13 of the exposure draft would be included in an analysis of determining the timing of write-off of exploration and evaluation assets and would not present a more stringent test than what is currently applied

As mentioned above, the level of uncertainty surrounding the recover ability of these costs is difficult to estimate until such time as the evaluation work is completed and any estimate of cash flow potential is unreliable in IFRS terms.

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 for 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?

Response:

Disclosures, when diverse practices are used in the industry, are needed to aid stakeholders in evaluating and comparing financial results across companies. With the exception of the disclosure related to impairment losses, and their subsequent reversal, we are in agreement and feel that many current non-IAS GAAP include this level of detail. For reasons noted earlier, in the area of exploration and evaluation expenses there should be no need for reversal of impairment losses and using current criteria would allow sufficient time to determine when an impairment is required. It is unlikely that a reversal of such costs would occur.

Shell appreciates the opportunity to express our views on the issues raised in the exposure draft. In summary, the overriding purpose of the exposure draft to allow for current processes and definitions to continue until a comprehensive project can be initiated and reviewed in sufficient detail is commendable. However, we believe that the exposure draft, as currently written, requires some unnecessary changes to the established processes and definitions, especially as it relates to impairment testing. We feel that there should not be any promulgated changes made in isolation but should only be agreed and implemented as part of the overall framework for the accounting for extractive industries.

We would be pleased to discuss these issues further if that would be helpful.

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