Australian Government

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Dear Colin

AASB staff response to the request for further comment on the special CGU proposal in IASB ED 6 *Exploration for and Evaluation of Mineral Resources*

In developing the following response, AASB staff have also considered the pre-ballot draft of IFRS 6 *Exploration for and Evaluation of Mineral Resources* and comments received from Australian entities that also responded to your request for further comment on the 'cash-generating unit for exploration and evaluation assets' (special CGU) proposal.

The view of AASB staff is that, given the IASB's strong preference for the impairment testing of exploration and evaluation assets in certain circumstances, the special CGU should be retained in IFRS 6 subject to some modifications that are outlined later in this letter. AASB staff's preferred option, however, is to completely exempt exploration and evaluation assets from IAS 36 *Impairment of Assets*. This would permit the full "grandfathering" of existing practice and significantly simplify IFRS 6.

The principle underlying this view, and indeed the AASB staff response to ED 6 *Exploration for and Evaluation of Mineral Resources* in general, is that the "interim" IFRS should allow for the continuation of existing practice in accounting for exploration and evaluation costs pending completion of the long-term project.

In Australia, existing practice includes area of interest accounting. Broadly speaking this involves an entity:

- capitalising its successful and unsuccessful exploration and evaluation costs within an area of interest (subject to certain conditions similar to those that are reflected in the "facts and circumstances" identified in pre-ballot draft IFRS 6.18); and
- if exploration and evaluation in the area of interest is successful, attributing all of those capitalised costs to the cost of a property within that area of interest that is being developed or produced; or

- if exploration and evaluation in the area of interest is unsuccessful, writing off those capitalised costs.

As you are aware, the ability for area of interest accounting and also full cost accounting to continue to be able to be applied under IFRS 6 is dependent not only on the suspension of the IAS 8 hierarchy but also on:

- when the capitalised costs are tested for impairment; and
- the level at which those costs are tested for impairment.

The IASB's revised "facts and circumstances" approach for determining when to test for impairment reduces the risk that an entity could be required to test for impairment, and presumably write-off its exploration and evaluation costs, when it is still actively exploring in a particular area. However, unless the IASB retains the special CGU, that risk will still remain for many entities, as is illustrated below.

Most cost centres will comprise several properties engaged in various phases of extractive operations including exploration and evaluation. Under the facts and circumstances approach, an entity is required to test its exploration and evaluation asset (being its cost centre) for impairment whenever, for example, an exploration property within a cost centre is abandoned. AASB staff expect that this fact and circumstance (IFRS 6.18(a)) would be "triggered" notwithstanding that exploration and evaluation operations at other properties within the cost centre are continuing or have proved successful. As a result, unless the special CGU is retained, IAS 36 would require recoverable amount to be calculated at an asset or cash-generating unit level rather than at the cost centre level. However undertaking an impairment test at this time and at this level produces an outcome more akin to successful efforts accounting than area of interest or full cost accounting. For example, if properties in the cost centre other than the abandoned property are:

- successful, then only the costs relating to those successful properties would be expected to be recoverable and can continue to be capitalised; and
- not yet successful but are the subject of continuing exploration and evaluation operations, then the costs relating those properties would not be expected to be recoverable at this point in time and therefore would be written–off.

This example also illustrates the anomaly in the application of the facts and circumstances approach to cost centres with a single property compared with cost centres with several properties. In contrast to the above example, where there is just a single property and exploration is either successful or still continuing, none of the facts and circumstances would be expected to be triggered and, as a result, those exploration and evaluation costs should continue to be able to be capitalised. Significantly, this anomalous outcome will not be resolved (but may be reduced) by the retention of the special CGU. It will be encountered whenever recoverable amount of a cost centre is required to be calculated and no properties within the cost centre are in production (or otherwise successful) but the entity is still actively exploring in those properties. This is because the recoverable amount of the cost centre is likely to be less than the exploration and evaluation costs that have been capitalised to that cost centre. AASB staff believe that the easiest way to overcome this anomaly is to remove the impairment testing requirement from IFRS 6 altogether.

Proposed modifications to special CGU definition

The following modifications to the definition of the special CGU are suggested if the IASB decides to retain the concept in IFRS 6:

- the special CGU should be defined by reference to the cost centre rather than at a "grandfathered" impairment testing level so that "new entrants" (i.e. entities that were not involved in exploration and evaluation prior to first-time adoption of IFRS) can also avail themselves of the special CGU; and
- the segment limit proposed for the definition should be removed for the reasons noted in our submission to ED 6.

Yours sincerely

David Boymal

David Boymal
Chairman