STAFF PAPER

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IASB Meeting

Project	Extractive Activities		
Paper topic	Asset recognition and unit of account		
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Objective

1. In March 2018 the Board issued the revised *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*). The changes introduced by the 2018 *Conceptual Framework* include a revised asset definition, revised concepts for the recognition of assets and additional concepts for selecting a unit of account.

2. In the 2010 *Extractive Activities* Discussion Paper (Discussion Paper) the project team proposed treating the cost of exploration and evaluation activities, which provided information about a mineral or oil and gas property, as assets (see paragraph 10). However, some respondents to the Discussion Paper indicated they believed that treating such activities as assets did not meet the definition or recognition criteria of an asset applying the 2010 *Conceptual Framework for Financial Reporting* (2010 *Conceptual Framework*).

3. The purpose of this paper is to:

   (a) identify the key changes to the definition of an asset and the asset recognition criteria between the 2010 *Conceptual Framework* and the 2018 *Conceptual Framework*; and

   (b) identify whether treating the cost of exploration and evaluation activities as assets, as proposed in the Discussion Paper, would be consistent with the definition of an asset and the asset recognition criteria in the 2018 *Conceptual Framework*.

4. There are no questions for the Board in this Agenda Paper, but the staff would welcome any comments from Board members.

Overview

5. This paper is structured as follows:

   (a) Summary (paragraphs 6–9);

   (b) Background (paragraphs 10–12);

   (c) Summary of feedback received on the Discussion Paper (paragraphs 13–18);

   (d) Applying the 2018 *Conceptual Framework for Financial Reporting* (paragraphs 19–43);

   (e) Appendix A—Extracts from ***October 2010 Agenda Paper 7A Comment letter summary***;

   (f) Appendix B—Key differences between the 2010 and 2018 *Conceptual Frameworks for Financial Reporting*.

Summary

6. Applying the 2010 *Conceptual Framework*, some respondents to the Discussion Paper observed that[1]:

   (a) enhancements to legal rights arising from subsequent exploration and evaluation activities did not meet the definition of an asset; and

   (b) additional guidance was needed to help entities determine an appropriate 'unit of account' for recognition of mineral or oil and gas properties.

7. In March 2018 the Board issued the revised *Conceptual Framework for Financial Reporting* (see paragraph 1).

[1] See ***October 2010 Agenda Paper 7A***

8. Staff consider that the cost of subsequent exploration and evaluation activities, in addition to the initial acquisition of legal rights, can give rise to an asset applying the 2018 *Conceptual Framework*. However, recognising the cost of such activities as assets is appropriate only if their recognition provides primary users with useful information (ie relevant information that provides a faithful representation of what it purports to represent).

9. Staff consider the proposal for unit of account in the Discussion Paper remains appropriate applying the 2018 *Conceptual Framework*, but that other units of account may be appropriate applying the 2018 *Conceptual Framework* and could provide users of financial statements with useful information. Therefore, the selection of an appropriate unit of account may need to be explored further.

Background

Asset recognition

10. In Chapter 3 of the Discussion Paper, the project team proposed that legal rights, such as exploration rights or extraction rights, should form the basis of an asset referred to as 'minerals or oil and gas property'. The property would be recognised when the legal rights are acquired. Subsequent to the acquisition of those rights, the property would be enhanced by:

    (a) information obtained from subsequent exploration and evaluation activities (eg information that will assist the entity in making assessments on the presence of minerals or oil and gas, the extent and characteristics of the deposit and the economics of its extraction);

    (b) development works undertaken to gain access to the minerals or oil and gas deposit; and

    (c) any additional rights and approvals required before the entity is legally entitled to extract the minerals or oil and gas.

Unit of account

11. Chapter 3 also considered the selection of a 'unit of account' for minerals or oil and gas properties. The project team proposed that such a unit of account has two attributes:

    (a) a geographical boundary—the unit of account would be defined initially on the basis of the exploration rights held. As exploration, evaluation and development activities take place, the unit of account would contract progressively until it becomes no greater than a single area, or group of contiguous areas, for which the legal rights are held and which is managed separately and would be expected to generate largely independent cash flows (eg a mine or field); and

    (b) a grouping of individual assets (ie components) that are integral to, and physically and commercially inseparable from, other assets within the unit of account.

Questions in the Discussion Paper

12. Questions 4 and 5 of the Discussion Paper asked respondents the following:

> **Question 4 – Minerals or oil and gas asset recognition model—recognition**
>
> In Chapter 3 the project team proposes that legal rights, such as exploration rights or extraction rights, should form the basis of an asset referred to as a 'minerals or oil and gas property'. The property is recognised when the legal rights are acquired. Information obtained from subsequent exploration and evaluation activities and development works undertaken to access the minerals or oil and gas deposit would each be treated as enhancements of the legal rights. Do you agree with this analysis for the recognition of a minerals or oil and gas property? If not, what assets should be recognised and when should they be recognised initially?

Question 5 – Mineral or oil and gas asset recognition model—unit of account selection

Chapter 3 also explains that selecting the unit of account for a minerals or oil and gas property involves identifying the geographical boundaries of the unit of account and the items that should be combined with other items and recognised as a single asset.

The project team's view is that the geographical boundary of the unit of account would be defined on the basis of the exploration rights held. As exploration, evaluation and development activities take place, the unit of account would contract progressively until it becomes a single area, or group of contiguous areas, for which the legal rights are held and which is managed separately and would be expected to generate largely independent cash flows.

The project team's view is that the components approach in IAS 16 *Property, Plant and Equipment* would apply to determine items that should be accounted for as a single asset.

Do you agree with this being the basis for selecting the unit of account of a minerals or oil and gas property? If not, what should be the unit of account and why?

Summary of feedback received on the Discussion Paper

13. The following is a summary of the comment letter analysis which was presented to the Board in October 2010[2]. Extracts of the detailed comment letter analysis from October 2010 are located in Appendix A.

Asset recognition

14. Respondents to the Discussion Paper included many individuals and organisations that had a specific interest in selected aspects of the Discussion Paper. Those respondents responded only to the questions that were within their direct area of

[2] See ***October 2010 Agenda Paper 7A***

interest. Consequently, not all respondents provided feedback on asset recognition.

15. Of those that responded to Question 4 (see paragraph 12):

    (a) most agreed with the proposal to recognise a ‘minerals or oil and gas property’ asset when the legal rights are acquired; and

    (b) almost all disagreed with the proposal that information obtained from subsequent exploration and evaluation activities would always enhance the property at the time that information is obtained.

16. Those respondents providing the feedback in paragraph 15(b) suggested that the project team’s treatment of the cost of those exploration and evaluation activities as assets was inconsistent with the asset recognition criteria in the 2010 *Conceptual Framework.* This is because information obtained from exploration and evaluation activities may not have any probable future economic benefit.

Unit of account

17. Of those that responded to Question 5, most generally agreed with the proposal (see paragraphs 11-12). However, many respondents indicated that additional guidance would need to be developed in order for the proposal to be capable of being applied in practice. For example, additional guidance was requested on determining the allocation of costs between separate units of account and on identifying the unit of account. Some respondents also suggested that an entity should be permitted to treat a group of properties that are near each other, but are not contiguous, as a single unit of account if those properties are managed as a single operation.

18. A few respondents encouraged the Board to continue to work on unit of account as part of its 2010 Conceptual Framework project and they suggested that this work might inform the identification of the appropriate unit of account for minerals or oil and gas properties.

Applying the 2018 *Conceptual Framework for Financial Reporting*

Asset recognition

19. Staff have identified the key differences between the 2010 and 2018 *Conceptual Frameworks* for the definition of an asset and the asset recognition criteria. These differences relate to (see Appendix B):

    (a) the definition of an asset;

    (b) recognition criteria for assets;

    (c) probability of economic benefits; and

    (d) measurement uncertainty.

20. The 2018 *Conceptual Framework* clarified the definition of an asset by removing a requirement for 'expected' future economic benefits. It instead defines an asset as a present economic resource controlled by the entity as a result of past events, and defines an economic resource as a right that has the 'potential' to produce economic benefits.[3]

21. Paragraph 4.14 of the 2018 *Conceptual Framework* goes on to clarify that:

    > … For that potential to exist, it does not need to be certain, or even likely, that the right will produce economic benefits. It is only necessary that the right already exists and that, in at least one circumstance, it would produce for the entity economic benefits beyond those available to all other parties.

22. The 2018 *Conceptual Framework* emphasises that an entity's asset is the right it holds rather than any object over which it holds those rights. Separately identifying and precisely describing all of the entity's rights can help with decisions about what the unit of account should be, whether and when each unit of account should be recognised and how each unit of account should be measured and presented.

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3 Paragraphs 4.3 and 4.4 of the 2018 *Conceptual Framework*

Recognition criteria

23. The 2010 *Conceptual Framework* stated that an item that meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured with reliability.

24. The criteria in 2018 *Conceptual Framework* are more principle-based. An asset or liability is recognised if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity; and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity.[4]

25. Where assets or liabilities for which the probability of an inflow or outflow of economic benefits is low, the 2018 *Conceptual Framework* states that:

> 5.16 If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes.
>
> 5.17 Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16. Whether that is the case may depend on a variety of factors. For example:
>
> (a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic

4 Paragraph 5.7 of the 2018 *Conceptual Framework*

> benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction (see paragraph 5.25(a)).
>
> (b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information.

26. Where assets or liabilities whose measurement is subject to significant uncertainty, the 2018 *Conceptual Framework* states that:

> 5.19 For an asset or liability to be recognised, it must be measured. In many cases, such measures must be estimated and are therefore subject to measurement uncertainty. As noted in paragraph 2.19, the use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information.
>
> 5.20 In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. The level of measurement uncertainty may be so high if, for example, the only way of estimating that measure of the asset or liability is by using cash-flow-based

measurement techniques and, in addition, one or more of the following circumstances exists:

(a) the range of possible outcomes is exceptionally wide and the probability of each outcome is exceptionally difficult to estimate.

(b) the measure is exceptionally sensitive to small changes in estimates of the probability of different outcomes—for example, if the probability of future cash inflows or outflows occurring is exceptionally low, but the magnitude of those cash inflows or outflows will be exceptionally high if they occur.

(c) measuring the asset or liability requires exceptionally difficult or exceptionally subjective allocations of cash flows that do not relate solely to the asset or liability being measured.

5.21 In some of the cases described in paragraph 5.20, the most useful information may be the measure that relies on the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. This is especially likely to be the case if that measure is the most relevant measure of the asset or liability. In other cases, if that information would not provide a sufficiently faithful representation of the asset or liability and of any resulting income, expenses or changes in equity, the most useful information may be a different measure (accompanied by any necessary descriptions and explanations) that is slightly less relevant but is subject to lower measurement uncertainty.

5.22 In limited circumstances, all relevant measures of an asset or liability that are available (or can be obtained) may be subject to such high measurement uncertainty that none would provide useful information about the asset or liability (and any resulting income, expenses or changes in equity), even if the measure were accompanied by a description of the estimates made in producing it and an explanation of the uncertainties that affect those estimates. In those limited circumstances, the asset or liability would not be recognised.

27. As explained in paragraph 3.12 of the Discussion Paper, there is a common sequence of activities undertaken by entities engaged in extractive activities. These activities usually start with the acquisition of legal rights to explore a defined area. Exploration and evaluation activities produce information about the geology and the presence and extent of any mineral or oil and gas deposit. Over time, the exploration and evaluation activities will increase the understanding of the deposit to the point at which an assessment can be made of whether there is a mineral or oil and gas deposit that can be economically developed.

28. If there is a mineral or oil and gas deposit that can be economically developed, an entity would then acquire the additional legal rights to extract the mineral or oil and gas. Assuming the deposit is developed, and production begins, the development and production activities will continue to generate information that will improve the entity's understanding of the deposit.

29. The analysis in this paper explores separately two features:

(a) legal rights (including additional rights and approvals) referred to as 'minerals or oil and gas property'—being various types of legal instruments that convey the legal rights to permit an entity to undertake exploration and extractive activities (see paragraphs 30–34); and

(b) information—being information about the property obtained through exploration and evaluation activities, which may include information about the existence of minerals or oil and gas, the extent and characteristics of the deposit, and the economics of their extraction (see paragraphs 35–39).

Legal rights

Example 1A—Applying the 2018 Conceptual Framework *to legal rights*

An entity is currently engaged in exploration and evaluation activities. During the reporting period, the entity has acquired legal rights over a tenement (ie a defined area of land) for the purpose of exploring for, and evaluating, gold resources. The legal rights include (see paragraph 3.13 of the Discussion Paper):

(a) a lease that was granted by the owner of the rights and provides the entity with the right to explore for minerals within the property (should the entity wish to extract those minerals it would need to also obtain the necessary rights and approvals); and

(b) terms and conditions of the lease that the entity must meet in order to maintain the legal rights over the tenement (for example, minimum spending requirements on exploration and evaluation activities to be performed on the tenement in order for the entity to maintain the legal right).

Do the legal rights meet the definition of an asset? (see paragraphs 4.3–4.25 of the 2018 *Conceptual Framework*)

Criterion	**Met?**	**Comments**
Right	✔	The entity has legally enforceable rights to explore a defined area.
Controlled by an entity	✔	The entity has the present ability to: • direct the use of the legal rights and to obtain the economic benefits that may flow from them; and • prevent other parties from directing their use and from obtaining the economic benefits that may flow from them.
As a result of past events	✔	The entity controls the legal rights as a result of its acquisition of those rights.
Potential to produce economic benefits	✔	Exploration rights have the potential to produce economic benefits in the form of information that will help the entity decide that it would beneficial to obtain extraction rights. The entity may also be able to sell the information to another party (see paragraph 4.16(d) of the 2018 *Conceptual Framework*). That information would not otherwise be available to other parties. It does not need to be certain, or even likely, that the exploration rights will produce information indicating that it

		would be beneficial to acquire additional rights and approvals to extract gold resources from the tenement.

⇩

Asset?	✔	The legal rights to explore a defined area meet the definition of an asset. They currently exist and are enforceable rights that have a potential to produce positive economic value at the date of acquisition. They have value because they enable an entity to explore for the unexpired duration of the time that the legal rights remain in existence and then to apply for other legal rights to extract any minerals that are found. The rights also have value because they preclude other entities from commencing those activities on that tenement.

Do the legal rights meet the recognition criteria for an asset? (see paragraphs 5.6–5.25 of the 2018 *Conceptual Framework*)

Criterion	**Met?**	**Comments**
Relevant information	?	Information about the legal rights (and related information) the entity has, and how much those legal rights were acquired for, is capable of making a difference in the decisions made by users. The asset exists (ie it meets the definition of an asset) however, it is uncertain whether there will be an inflow of economic benefits as this will depend on whether the entity identifies that an economically viable gold deposit exists. Even if the probability of an inflow of economic benefits is low, recognition of the legal rights as an asset may provide relevant information beyond: i. the magnitude of possible inflows; ii. their possible timing; and iii. the factors affecting the probability of their occurrence. In an exchange transaction where the cost generally reflects the probability of an inflow or outflow of economic benefits, the cost may be relevant information (paragraph 5.17(a) of the 2018 *Conceptual Framework*).
Can be faithfully represented	✔	The acquisition cost of the legal rights can be measured with certainty by referring to the contract in place between the owner of the tenement and the entity. However, other factors

		as per paragraphs 5.24–5.25 of the 2018 *Conceptual Framework* should also be considered.
	⇩	
Recognised asset?	✔	The legal rights held by the entity over the tenement can be recognised as an asset. In this specific circumstance, as there is a low probability of inflow of economic benefits in the future, additional disclosure about why such information is relevant, or necessary, to primary users may be useful.

30. In Example 1A, when referring to the revised definition of an asset and the asset recognition criteria in the 2018 *Conceptual Framework*, the recognition of legal rights to explore a defined area as an asset is possible. In line with the project team's considerations in paragraph 3.14 of the Discussion Paper, the rights currently exist, are enforceable and have a positive economic value at the date of acquisition. They have value because they enable the entity to explore for the unexpired duration of time that the legal rights remain in existence and then to apply for other legal rights, if necessary, to extract any minerals or oil and gas that are found. The rights also have value because they preclude other entities from commencing those activities. In other words, a legal right is a present economic resource that can be controlled by an entity as a result of past events.

31. Further, as explained in paragraph 4.17 of the 2018 *Conceptual Framework*, although an economic resource derives its value from its present potential to produce future economic benefits, the economic resource is the present right that contains that potential, not the future economic benefits that the right may produce.

32. However, the probability of inflow of economic benefits in the exploration and evaluation stages is generally low because this will depend on:

    (a) whether the entity identifies that an economically viable mineral or oil and gas deposit exists; or

    (b) whether the entity is able to profitably dispose of the legal rights.

33. Paragraphs 5.6–5.25 of the 2018 *Conceptual Framework* specify recognition criteria for assets, liabilities and equity. In summary, an asset should be recognised only if recognition provides users of financial statements with useful

information (ie with relevant information about the asset and a faithful representation of that asset).

34. Consequently, staff believe that legal rights (as described in paragraph 30) can meet the revised recognition criteria of an asset in the 2018 *Conceptual Framework* as:

    (a) the recognition of a legal right as an asset can provide relevant information which is capable of making a difference to the decisions made by primary users (see paragraphs 2.6–2.11 of the 2018 *Conceptual Framework*). For example, a primary user may make decisions about providing resources to an entity based on the legal rights an entity has to explore and extract mineral or oil and gas properties from a defined area;

    (b) if the legal right is acquired in an exchange transaction on market terms, its cost generally reflects the probability of an inflow of economic benefits. Therefore, the cost of acquiring the legal right may be relevant information and its recognition as an expense, as opposed to an asset, might not be a faithful representation of the legal right (see paragraph 5.17(a) of the 2018 *Conceptual Framework*); and

    (c) the legal right can be faithfully represented. As discussed in paragraph 30, legal rights are enforceable rights that have a positive economic value, and can be reliably measured, at the date of acquisition.

Information

Example 1B—Applying the 2018 Conceptual Framework *to information*

In the year following the acquisition of legal rights to explore the tenement, the entity has performed significant exploration activities to better understand the extent and characteristics of the potential gold deposit. However, the entity's management is still uncertain whether extraction of gold resources from the property is economically viable. It estimates that further exploration and evaluation will be required to reach a determination.

Does information obtained through exploration and evaluation activities (such as sampling or drilling) meet the definition of an asset?

Criterion	**Met?**	**Comments**
Right	✔	The entity has a right to use the information obtained during its exploration and evaluation activities. This can be viewed as an enhancement of its legal rights. For example, if the entity decides to abandon the tenement, it may sell both the information and its legal rights.
Controlled by an entity	✔	The entity has the present ability to direct the use of the information it obtained via exploration and evaluation activities and can obtain any economic benefits that may flow from it.
As a result of past events	✔	The information exists as a result of past activities of the entity, such as the acquisition of legal rights and from the exploration and evaluation activities (for example, drilling, trenching, and sampling).
Potential to produce economic benefits	✔	The information has the potential to produce economic benefits for the entity that are not available to other parties (ie the entity has a legal right to obtain additional legal rights to develop and extract any mineral property from the tenement). Further, the entity can use the information to determine the extent of future exploration and evaluation activities and development and production activities from which it may benefit should the potential gold deposit be economically viable.

⇩

Asset?	✔	The benefit from information produced as a result of exploration and evaluation activities performed on the tenement meets the definition of an asset. The information has the potential to have positive economic value because it can enhance the existing legal rights asset by reducing geological and economic uncertainty.

Does the information obtained from exploration and evaluation activities meet the recognition criteria for an asset?

Criterion	**Met?**	**Comments**
Relevant information	?	Information about the extent and characteristics of gold or other mineral properties is capable of making a difference to the decisions made by users by enhancing the existing legal rights asset. For example, an investor or lender may provide resources to the entity if the information generated from its exploration and evaluation activities indicate that there is an economically viable gold deposit that will be profitable. The asset exists (ie it meets the definition of an asset) however the probability of inflow of economic benefits is currently low because this will depend on whether the entity identifies that an economically viable gold deposit exists.
Can be faithfully represented	✔	The cost of exploration and evaluation activities which generate information exist and can be measured on a historical cost basis (ie if the entity capitalises exploration and evaluation costs based on the cost of such activities as they occur). Measurement uncertainty would be high if the asset was recognised on the basis of fair value. This is because exploration and evaluation activities which generate information are primarily service-based and rely on multiple factors relating specifically to the type of exploration activity performed and the geology, access, topology, etc. of the defined area itself.

⇩

Recognised asset?	?	Despite there being a low probability of inflow of economic benefits, information meets the definition of an asset. However, whether the asset should be recognised should be considered further (as should whether the asset is separate from the legal rights as described in Example 1A).

35. In the Discussion Paper, the project team explained that information about the property can be associated with the legal rights. Paragraph 3.18 of the Discussion Paper considered that often, when exploration rights to a property are first acquired, information about that property is very limited and there are significant uncertainties. Nonetheless, the decision to acquire the legal rights for a particular property therefore implies at least some degree of information, however limited.

Thus, the project team concluded that information about a property does not represent a separate asset but rather is an integral part of the legal rights asset, being the right to explore for and extract minerals or oil and gas.

36. The project team explained that, over time, detailed exploration and evaluation activities provide more information and thereby reduce geological and economic uncertainty. Geological and economic uncertainty also continue to reduce as a result of development and production activities. However, the proposal acknowledged that new information may not always add value to the legal rights asset. For example, exploration results may either increase or decrease the probability that there are economically producible reserves.

37. Despite concerns raised by respondents to the Discussion Paper about recognising information obtained from exploration and evaluation activities as enhancements of the legal rights assets (see paragraph 15(b)), staff believe that, in line with the project team's proposal, such information can enhance the legal rights asset applying the 2018 *Conceptual Framework* (see Example 1B).

38. To decide whether this asset should be recognised, we refer to paragraphs 5.12–5.25 in the 2018 *Conceptual Framework* which provide guidance on:

    (a) existence uncertainty (relevance)—information obtained as a result of exploration and evaluation activities currently exists; and

    (b) probability of an inflow of economic benefits (relevance)—feedback from respondents primarily focused on the probability of future economic benefits when assessing whether exploration and evaluation activities can enhance a legal rights asset. Paragraph 5.15 of the 2018 *Conceptual Framework* states that 'an asset can exist even if the probability of an inflow of economic benefits is low.' Paragraphs 5.16 and 5.17 of the 2018 *Conceptual Framework* provides further guidance in such instances and suggests that recognition should occur only if, in addition to faithful representation, such recognition provides relevant information to primary users.

39. Although information obtained from exploration and evaluation activities may meet the definition of an asset, we acknowledge that the decision of whether the asset should be recognised would need to be carefully considered—that is, the

Board would need to consider if new information obtained from exploration and evaluation activities would always enhance a legal rights asset.

Unit of account

40. Unlike the 2010 *Conceptual Framework*, the 2018 *Conceptual Framework* includes concepts to assist in selecting a unit of account to provide useful information in paragraphs 4.48–4.55.

41. Paragraph 4.48 of the 2018 *Conceptual Framework* defines a unit of account as being ‘the right or group of rights, the obligation or the group of obligations, to which recognition criteria and measurement concepts are applied’. The Discussion Paper identified two factors to consider in selecting a unit of account for minerals or oil and gas properties:

    (a) the geographical boundaries of the asset; and

    (b) the components of the unit of account that are to be recognised as a single asset.

42. Applying the 2018 *Conceptual Framework,* it remains appropriate to consider those factors. This is because, as explained in paragraphs 3.39–3.41 of the Discussion Paper, the unit of account and its considerations were developed based on the factors of:

    (a) adherence to generally accepted accounting principles so that the unit of account fits within the broader accounting system; and

    (b) meeting the information needs of users of financial reports.

43. However, in applying paragraphs 4.48–4.55 of the 2018 *Conceptual Framework*, alternative units of account may be deemed appropriate where they provide more useful information to users of financial statements. For example, exploration rights and extractive rights can be viewed as a single unit of account, or they can be viewed as separate units of account.

Appendix A—Extracts from *October 2010 Agenda Paper 7A Comment letter summary*

Recognition (Question 4)

A1. Less than two thirds of the respondents responded on this issue. Of those that responded:

(a) most agreed with the proposal to recognise an asset when the legal rights are acquired; and

(b) a significant majority disagreed with the project team's view that the subsequent exploration and evaluation activities undertaken would always represent an enhancement of the property (at least at the time that information is obtained).

A2. Many of those respondents suggested that the project team's analysis of the treatment of those exploration and evaluation activities was inconsistent with the asset recognition criteria in the *Conceptual Framework* because the information obtained may not have any probable future economic benefit. As one respondent explained:

> *…we think it is worth noting that exploration activity generally has a success-rate significantly below 50% i.e. the probability criterion is clearly not satisfied at the individual asset level. An often-used rule of thumb for oil and gas exploration drilling (assuming the activity is not very close to existing known reservoirs), for example, is a success rate of 20%. Using the project team's suggested recognition model under this assumption (without going into the impairment criteria) and further e.g. assume average evaluation expenditures would be recognized as expenses 18 months later than they occurred. We do not believe this model would give more useful information to the users than e.g. a model under which all exploration expenditures are recognised as expenses when incurred. (CL#82)*

A3. Respondents urged the Board to further consider asset recognition. Respondents made the following suggestions for alternative approaches for accounting for extractive activities:

(a) to recognise a minerals or oil and gas property assets on the same basis as other assets, such as in accordance with IAS 38 and IAS 16. (Respondents that supported this approach to asset recognition typically also recommend that the scope of a future project should extend beyond extractive activities);

(b) to use the reserve and resource classifications to identify the appropriate point to initially recognise the asset; or

(c) to use existing accounting methods that are commonly used and understood within the industries. Those methods include the successful efforts method and the full cost method, which are historical cost accounting methods that determine whether a cost is capitalized or expensed based on the phase of operation (eg exploration or development) and the activity being undertaken.

A4. In addition, some respondents—particularly some large oil and gas companies that have long-standing accounting policies that are consistent with US GAAP—indicated that the Discussion Paper does not adequately make the case for changing existing accounting policies that are being consistently applied and that are well understood by users of financial statements.

A5. One respondent had a different perspective on asset recognition for extractive activities. That respondent stated:

> *We think that asset recognition for extractive industries is an "all or nothing" situation, meaning an entity either fully capitalizes expenditures or expenses them, because any attempt at setting up parameters in the middle (e.g. by "stage" of activity) will be arbitrary. The accounting model applicable to extractive activities should recognize this fact. (CL#120)*

Unit of account (Question 5)

A6. About two thirds of the respondents provided comments on this issue. Of those that responded, a majority of the respondents generally agreed with the proposal. However, many respondents indicated that additional guidance would need to be developed in order for the project team's proposal to be capable of being applied in practice. For instance, additional guidance was requested on determining the allocation of costs between separate units of account and on identifying the unit of account. Some respondents also suggested that an entity should be permitted to treat a group of properties that are near each other, but are not contiguous, as a single unit of account if those properties are managed as a single operation.

A7. A few respondents encouraged the Board to continue work on unit of account as part of its *Conceptual Framework* and they suggested that this work might inform the identification of the appropriate unit of account for minerals or oil and gas assets.

Appendix B—Key differences between the 2010 and 2018 *Conceptual Framework for Financial Reporting*

2010 *Conceptual Framework*	**2018 *Conceptual Framework***
Definition of an asset (paragraphs 4.4 and 4.8–4.14) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.	*Definition of an asset* (paragraphs 4.3–4.25) An asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.
Recognition criteria (paragraphs 4.37–4.45) An item that meets the definition of an element should be recognised if: (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability	*Recognition criteria* (paragraphs 5.7 and 5.12–5.25) An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with: (a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity; and (b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity.

2010 ***Conceptual Framework***	2018 ***Conceptual Framework***
Probability of economic benefits (paragraphs 4.40 and 4.44–4.45) The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. The concept is in keeping with the uncertainty that characterises the environment in which an entity operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared.	*Probability of economic benefits* (paragraphs 5.15–5.17) An asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low. If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes. Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16.
Measurement uncertainty (paragraphs 4.41–4.43) The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the balance sheet or income statement.	*Measurement uncertainty* (paragraphs 5.19–5.23) For an asset or liability to be recognised, it must be measured. In many cases, such measures must be estimated and are therefore subject to measurement uncertainty. As noted in paragraph 2.19, the use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information. In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity.