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7 February 2008

The Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street,
LONDON EC4M 6XH
UNITED KINGDOM

Dear Sir,

Re: Tentative agenda decision on IAS 7 Statement of Cash Flows – Classification of expenditures

We refer to the IFRIC's tentative agenda decision on IAS 7 Statement of Cash Flows (classification of expenditures).

The IFRIC's decision followed a request for it to issue guidance on the classification of some types of expenditure (and specifically exploration and evaluation expenditure in extractive industries) in the statement of cash flows. Other types of expenditure referred to were research and development activities, advertising and promotional activities and staff training. The request asked for guidance as to whether such expenditure should be classified as arising from operating or investing activities in the statement of cash flows. The submission stated that divergence had developed in this area with some entities believing that all such cash flows should be treated as arising from operating activities and others believing that entities had a choice between presenting the cash flows as either operating or investing activities.

The IFRIC concluded that the issue could be best resolved by referring it to the Board with a recommendation that IAS 7 should be amended to make explicit that only expenditure that results in a recognised asset can be classified as a cash flow from investing activity. The IFRIC therefore decided not to add the issue to its agenda.

We agree that the IFRIC should not add this issue to its agenda but we disagree with the IFRIC's decision to refer the matter to the IASB together with a recommendation to amend IAS7 in the manner described above. There are two key matters on which we disagree with the IFRIC:

1. We do not believe there is significant divergence in practice which warrants this issue being considered by the IFRIC and requiring resolution by either the IFRIC or the IASB. Rather, from our knowledge of the practice of other (IFRS

compliant) major mining companies, the issue appears to be raised as a result of a single divergent view.

2. We do not believe that IAS 7 should be amended to be more explicit and require that only expenditure that results in a recognised asset can be classified as a cash flow from investing activity. We believe this would be in conflict with the basic premise of the definitions stated by IAS 7, it would contradict the principles based approach of IFRS and would infuse IFRS with a US GAAP bias that is unsound and irrelevant to IFRS. Further, given the policy choice permitted by IFRS 6 "Exploration for and Evaluation of Mineral Resources" to either capitalise or expense exploration and evaluation expenditure, the proposed amendment would mean that choice of accounting policy under IFRS6 will result in a totally different treatment in the cash flow statement by companies incurring expenditure that is identical in nature. This is not only contrary to the intent of IAS 7, which is to present cash flows from operating, investing and financing activities in a manner which is most appropriate to the business, it also fails to classify cash flow according to its nature and prevents comparability by users of the financial statement of companies which are undertaking the same activities

These points are expanded upon below.

1. No significant divergence in practice

We do not believe there is a significant divergence in practice which warrants this issue being considered by the IFRIC and requiring resolution by either the IFRIC or the IASB. In addition to BHP Billiton classifying exploration expenditure as investing cash flows regardless of how that expenditure is dealt with in the income statement or balance sheet, Rio Tinto and Total (as further examples) also classified exploration expenditure as investing prior to intervention by the Securities and Exchange Commission (SEC). Rio Tinto changed their presentation to classify exploration expenditure as operating only after the SEC disagreed with this presentation and sought a change in policy. The SEC also disputed BHP Billiton's classification of exploration expenditure in the cash flow when it reviewed the 2006 BHP Billiton Form 20F. After lengthy discussions, the SEC recognised the merit of BHP Billiton's position on the issue in the context of the requirements of the standard and therefore agreed that it had no basis to object to the treatment adopted by BHP Billiton. It was evident, however, that the SEC was not comfortable with the interpretation required to apply the standard. As a result, we believe the presentation of exploration expenditure as investing cash flows has been consistently applied by major participants in the extractive industries and is not seen as a matter of significant divergent practice. Rather, we believe there is a divergent view from the SEC.

In addition, from our knowledge of industry practice, analyst expectations and experience in the Australian mining community which has applied the Australian equivalent of this standard for an extended period prior to IFRS transition, the classification of exploration expenditure in the cash flow has been accepted and understood as appropriate on a consistent basis for many years.

2. IAS 7 does not require amendment

(i) View 1 – the supportive view

We concur with the arguments presented in paragraphs 7 to 17 of the Information for Observers Agenda Paper 7B to the IFRIC Meeting of January 2008. In particular:

- paragraph 11 of IAS 7 requires management to use their discretion in classifying cash flows by activity and provides an over-riding principle to classify by activity,
- Paragraph 14 of IAS 7 defines what operating activities are and importantly does not preclude classifying some items which may be included in the profit and loss as investing activities,
- The activity of investing is defined as "the acquisition and disposal of long-term assets and other investments not included in cash equivalents" (paragraph 6 of IAS 7) and the resulting disclosures of investing cash flows is intended to represent "the extent to which expenditures have been made for resources intended to generate future income and cash" (paragraph 16 of IAS 7). The requirements of paragraph 6 do not state that an asset must be recorded. These two principles referred to in paragraphs 6 and 16 indicate that investing expenditure is discretionary in nature with the objective of generating income in the future, is not related to the principal revenue-producing activity and therefore not required to maintain ongoing operations. Clearly, exploration expenditure falls within this category.

To impose a rule such as mandating the recognition of an asset prior to classification of cash flows as investing, conflicts with the entire "classification by activity" principle upon which IAS 7 has been successfully applied for many years. In addition, the gradual introduction of rules into a principle based regime is contrary to the basic design premise of IFRS. An attempt to satisfy one view as to the appropriate classification of one item by way of a rule as proposed is fraught with danger and will confuse the role of management in exercising judgement as to what is most appropriate in the circumstances.

A further example the IFRIC should recognise is the classification of cash flows to settle interest accrued on a zero coupon bond. The nature of such cash flows is to service debt and most preparers would recognise and treat it as an operating cash flow. Introducing a classification rule that references the balance sheet will confuse the matter. Because the cash settlement of the interest accrued is extinguishing a liability, does the payment now become a financing cash flow? This would be contrary to the principle of classification based on the nature of the activity being reported.

Further, given the policy choice available in IFRS 6, the introduction of a rule into IAS7 may influence how IFRS 6 is applied by extractive industry companies (i.e. they may change from expensing some exploration expenditure to a capitalise and impair approach) in order for them to present a more pertinent disclosure in the cash-flow statement. We do not believe that the policy selected for the accounting for exploration expenditure, nor the results of that exploration activity, should influence the classification of that expenditure in the statement of cash-flow. Rather, that classification should be based on the purpose of the underlying activity.

It should be noted that the classification of exploration expenditure as investing expenditure in the cash flow statement has been repeatedly endorsed by external auditors in their signing of annual and half year financial reports and in recent detailed discussions with the SEC upon their review of Form 20-F filings by foreign registrants.

(ii) View 2 – the dissenting view

We disagree with the points put forward by the proponents of View 2 on the following basis:

Paragraph 19
"Supporters of view 2 note that expenditure that is recognised as an expense as incurred is included in the determination of profit or loss. IAS 7.14 therefore implies that such expenditure is an operating activity"

Paragraph 14 states "*Cash flows from operating activities are primarily derived from the principal revenue- producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash-flows from operating activities are:...*

(several specific examples are listed)

...Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities"

There is no inference in paragraph 14 that exploration expenditures should be classified as an operating activity. The use of words such as "generally result from the transactions and other events that enter into the determination of profit and loss" certainly do not preclude some items included in the profit loss from being classified as investing. This point is further expanded upon in the use of the example of the sale of the item of plant.

Paragraph 20
"This view is further supported by IAS 7.16 which gives examples of cash flows from investing activities. Paragraph 16(a) states that cash flows from investing activities include cash payments to acquire property, plant and equipment, intangibles and other long term assets. These payments include those relating to capitalised development costs and self constructed property, plant and equipment"

Paragraph 21
"Supporters of view 2 argue that the Board would not have restricted the wording in paragraph 16(a) to capitalised costs if it intended entities to classify expenditure that does not give rise to a recognised asset to be included as investing cash flow."

The above paragraph omits the important preface in paragraph 16. The preface states "The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of such cash flows arising from investing activities are..." The example quoted above is the first in a long list of examples.

It is important that the example is read in context with the preface as the preface reiterates the principles under which cash flows should be classified as investing. The list which follows provides examples of the types of costs which are included as investing. It is not described as a complete or exhaustive list.

Although the example noted above refers to "capitalised development costs", other sections of IAS 7 refer to the situation where items may be included in the profit and loss statement yet included in investing cash flows. As a result, the reference to the inclusion of a "capitalised" item in investing is not a pre-requisite to this classification.

Further, we refer specifically to the text of the preface which explains that investing cash flows represent expenditures made for <u>resources to generate future cash flow</u>. This is precisely the nature of exploration expenditure – it is incurred in a search for resources that is clearly unrelated to the generation of present operating cash flows, but is incurred with a view to increasing the future operating cash flow capability of the entity. For this reason, it is potentially misleading to classify exploration expenditure as operating in nature, and doing so fails to provide information critical to users who seek to understand the extent of investment made in exploration activity in order to better anticipate future cash flow potential. Many participants in the extractive industry make regular voluntary disclosures of their exploration expenditure. This is done to meet the information needs of users who develop expectations of future potential operating cash flows based on the level of exploration effort.

Paragraph 22
"Supporters of view 2 do not accept that exploration and evaluation expenditure is a special case. They note that the exemption in IFRS 6 refers only to recognition and measurement not to cash classification. Neither IFRS 6 nor IAS 7 refer to an exemption in the case of the statement of cash flows."

Generally, the IFRS topical standards do not provide guidance on cash classification. As a result, it is not surprising that IFRS 6 refers only to recognition and measurement.

As the current version of the Cash Flow standard was drafted many years prior to the Exploration and Evaluation (and several other) standards, it is not unexpected that the Cash Flow standard does not specifically comment on and provide guidance for the treatment of the exemption available in the Exploration and Evaluation standard. In taking the path proposed by IFRIC staff, would the IASB intend to make specific reference to all topic areas covered by IFRS and therefore become "rules based" in line with US GAAP?

(iii) The staff's views

In addition to supporting the views proposed by supporters of view 2, the staff's conclusions in paragraph 37 goes on to note "The staff has concerns that, if expenditure that gives rise to an unrecognised asset can be classified as investing then a whole range of cash flows may be reclassified from operating to investing. This kind of reclassification may result in an overstatement of operating inflows and an overstatement of investing activities. This treatment would also lead to divergence with USGAAP"

Given the definition of investing cash flows and the requirement for these expenditures to be made for resources intended to generate future income and cash flows, we do not believe there are a significant number of unrecorded assets which would clearly qualify as investing activities. Of the examples of activities which were described in the paper (research and development activities, advertising and promotional activities, costs of repairs and maintenance and staff training), only research and development can be described as an activity which is entirely discretionary and undertaken to generate future income and cash flows. Activities such as staff training and advertising and promotional activities will have a dual purpose of supporting existing principal revenue-generating activities as well as potentially generating future income and cash flows.

Further, we do not believe that divergence from USGAAP should be the basis for a change in IFRS, particularly when the SEC is making further moves to permit US entities to report under IFRS rather than US GAAP. It should also be noted that US practice in relation to the matter of cash flow classification is driven by a US accounting standard for cash flow reporting which uses different descriptions of operating and investing cash flows and is not based on the same principles described above.

The staff concluded that "whilst the current literature is reasonably clear that only expenditure that results in an asset that may be recognised should be classified within investing activities, the wording of the standard is not definitive in this respect.

The staff considers that the issue could most efficiently be resolved by referring it to the Board to be addressed as part of the annual improvements process."

We disagree with the staff's conclusion that IAS 7 requires consideration of the outcome of the transaction (i.e. recognition of an asset) to determine if expenditure is investing in nature. Although IAS 7 does not specifically refer to the treatment of exploration cash flows, it requires management to use their discretion in classifying by activity and provides an over-riding principle to classify by activity.

3. Conclusion

As a result of the reasons outlined above, we request the IFRIC reconsider their decision to refer this issue to the IASB. We do not believe there is sufficient divergence or misunderstanding on this issue to warrant referral to the IASB. In the event that the IFRIC and subsequently the IASB still believe that clarification is required, we request that consideration is given to including exploration expenditure as an example in paragraph 16 to reinforce that the intent of this activity, as required by the principle of the standard, is investing in nature.

As explained above, exploration expenditure undertaken by participants in the extractive industries is a key leading indicator used by investors to make judgements about the future prospects and cash generating ability of the entity. Classifying this expenditure as operating is contrary to its nature and would cause it to be lost amongst other regular operating payments. This lack of transparency would undermine the relevance of the cash flow statement and would force additional supplementary (non-GAAP) information necessary to meet the needs of users that remain unsatisfied by IFRS..

We would like to take this opportunity to thank the IFRIC for providing this opportunity to comment.

Yours sincerely,

Nigel Chadwick
Group Financial Controller