IFRS Accounting

STAFF PAPER

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Project	**Extractive Activities**
Paper topic	Disclosure feedback summary

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Objective

1. As explained in Agenda Paper 19, this paper summarises disclosure-related feedback and suggestions about exploration and evaluation (E&E) expenditure and activities from research conducted between 2018-2021 (prior research), relevant academic literature and jurisdictional requirements and other proposals.

Structure of this paper

2. This paper is set out as follows:

    (a) Review of prior research (paragraphs 3–18);

    (b) Review of academic evidence (paragraphs 19–26);

    (c) Review of other requirements and proposals to provide information about E&E expenditure and activities (paragraphs 27–31);

    (d) Summary (paragraphs 32–33); and

    (e) Appendix—Suggestions we decided not to consider further.

Review of prior research

3. During the prior research, many stakeholders provided disclosure-related feedback and made disclosure suggestions. We reviewed these suggestions and identified three broad categories of information about E&E expenditure and activities that the suggestions related to:

   (a) information to help understand the accounting for E&E expenditure (paragraphs 7–11);

   (b) information to help compare entities with different accounting policies for E&E expenditure (paragraphs 12–13); and

   (c) information to help understand the risks and uncertainties of E&E activities (paragraphs 14–18).

4. We did not limit our review to disclosure suggestions about only E&E expenditure and activities. For example, some stakeholders provided feedback on disclosures about risks and uncertainties related to extractive activities more generally, but this feedback also applies to E&E expenditure and activities and was included in our review.

5. As explained in Agenda Paper 19, this paper summarises our findings and Agenda Paper 19C analyses these findings.

6. We identified some suggestions that do not fit within the project's scope and objectives. Accordingly, we did not consider these further. The Appendix lists these suggestions together with our analysis of why these suggestions do not fit.

Information to help understand the accounting for E&E expenditure

7. IFRS 6 provides an entity with a temporary exemption from applying some paragraphs of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing its accounting policies for the recognition and measurement of E&E assets. Prior research highlighted that entities continued to apply diverse accounting policies to E&E expenditure (see October 2020 Agenda Paper 19A).

8. Paragraph 24 of IFRS 6 requires an entity to disclose its accounting policies for E&E expenditure including the recognition of E&E assets. However, prior research identified that it was sometimes unclear how entities account for E&E expenditure.

9. Many stakeholders providing disclosure-related feedback suggested that entities could improve disclosures of their accounting policies for E&E expenditure. For example:

   (a) at roundtables held by two national standard-setters, participants said in their view the accounting policies applied to E&E expenditure were not always well disclosed.

   (b) in a survey we conducted of users, many suggested requiring entities to improve disclosures about their accounting policies for E&E expenditure rather than reduce the diversity of the accounting applied to E&E expenditure.

   (c) at the March 2019 meeting of the International Accounting Standards Board's Capital Markets Advisory Committee (CMAC), some CMAC members made similar comments. One CMAC member said the information entities currently disclose in this respect is not sufficiently transparent.

10. However, a few preparers from both mining and oil and gas industries, said users do not ask about their accounting policies, and information about E&E activity is more important than information about the accounting for E&E expenditure.

11. The following specific accounting policy-related disclosure suggestions were made:

   (a) One regulator said entities do not disclose sufficient information on a number of key aspects of their accounting policies for E&E expenditure. For example:

      (i) whether entities have a legal right to explore;

      (ii) when a project moves from the E&E phase to the production phase; and

(iii) the unit of account used to accumulate E&E expenditure and how that relates to the cash-generating unit used for impairment testing.[1]

(b) Preparers from Australia said IFRS 6 does not define ‘area of interest’ which, in their view, is not helpful.[2] They said more disclosure, describing the area of interest, could lead to greater comparability.

(c) Another preparer from a different jurisdiction said users do not understand differences in units of account used and whether expenditure related to failed exploration is carried forward as an asset.

(d) Another national standard-setter said users in their jurisdiction want more information on the nature and type of E&E expenditure capitalised. IFRS 6 provides a non-exhaustive list of examples of E&E expenditure.

Information to help compare entities with different accounting policies for E&E expenditure

12. In addition to the requirement for entities to disclose their accounting policies for E&E expenditure including the recognition of E&E assets, IFRS 6 requires entities to:

(a) disclose the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.

(b) treat E&E assets as a separate class of assets and make the disclosures required by either IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets* consistent with how the assets are classified. This includes, for example, requiring an entity to disclose a reconciliation of the carrying amount for each class of property, plant and equipment at the beginning and end of the period (see paragraph 73(e) of IAS 16).

[1] IFRS 6 requires an entity to determine an accounting policy for allocating E&E assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment.

[2] AASB 6 *Exploration for and Evaluation of Mineral Resources*, the Australian equivalent of IFRS 6, requires an entity to decide separately for each ‘area of interest’ whether expenditure incurred in the exploration for and evaluation of mineral resources shall be expensed as incurred or, partially or fully capitalised. AASB 6 defines an area of interest as ‘An individual geological area which is considered to constitute a favourable environment for the presence of a mineral deposit or an oil or natural gas field, or has been proved to contain such a deposit or field’.

13. Stakeholders said they need more information to be able to compare entities that apply different accounting policies. In particular:

    (a) at the March 2019 CMAC meeting, one CMAC member said better information about E&E expenditure and what entities that expense E&E expenditure would have capitalised would be useful. This information would allow users to make necessary adjustments when comparing entities with different accounting policies.

    (b) one user (in feedback gathered by a national standard-setter) said as long as entities disclose adequate information, diversity in accounting policies can be managed.

    (c) one CMAC member said they find it challenging to reconcile the disclosed accounting policies for E&E expenditure to the line items in the financial statements and suggested requiring entities to disclose in a table the amounts expensed, written-off and capitalised by line items during a reporting period.

    (d) feedback from stakeholders reported by a national standard-setter explained that capitalising E&E expenditure provides better continuity and allows users to easily track project expenditure on a cumulative basis.

Information to help understand the risks and uncertainties of E&E activities

14. Many stakeholders providing disclosure-related feedback said more information about E&E activities could be useful. In particular one national standard-setter said IFRS 6 was issued as an interim standard and does not require entities to disclose information to enable users to understand the risks and uncertainties about extractive activities. They said financial reporting requirements about other activities have evolved to require disclosures about the nature and risks of the activities. In their view, further work is needed to assess whether entities should be required to disclose better information about E&E activities.

15. As explained in paragraph 10, a few preparers said users find information about E&E activities more important than the accounting for E&E expenditure. One user we spoke to also said information about E&E activity is more important than the numbers in some cases.

16. These stakeholders gave examples of information about E&E activities that could be useful:

    (a) stage of the activity and key milestones, for example in prospecting, exploration, conceptual studies, pre-feasibility and feasibility studies and project execution;

    (b) outcome;

    (c) geographical location;

    (d) is the project on a greenfield (in an area not adjacent to any other projects or proven reserves) or brownfield (in an area adjacent to proven reserves) site;

    (e) geological information;

    (f) political risks; and

    (g) climate risks.

17. Some entities disclose this type of information outside financial statements. One national standard-setter said users in their jurisdiction said entities disclose useful information outside financial statements. During a panel discussion at a national standard-setter's research forum, one preparer said there should be a link between the information disclosed outside the financial statements, in accordance with their local regulatory requirements, and the information disclosed in financial statements.

18. One preparer cautioned against extending disclosure requirements, saying the disclosure burden would be much heavier for small junior exploration entities. However, one national standard-setter said information could be incorporated through cross-referencing if already disclosed outside financial statements.

Review of academic evidence

19. There is limited academic evidence available on disclosures about E&E expenditure and activities. Of the studies we identified, many assessed compliance with IFRS 6's disclosure requirements. As discussed below, these studies generally concluded that compliance with those requirements is low or could be improved.

20. One study highlighted that 16% of that study's sample of 118 oil and gas entities from six major stock exchanges in the period 2006–2014 did not clearly disclose the accounting policies or the accounting methods used for E&E expenditure.[3] The study found that entities in their sample seemed to not fully comply with IFRS 6's disclosure requirements, including the requirement to disclose amounts of assets, liabilities, income and expense and operating and investing cash flows arising from E&E expenditure.

21. Another study of the five largest oil and gas entities in India and five Fortune 500 oil and gas companies during 2017–2019 found:

    (a) for some entities it was not possible to tell whether geological and geophysical costs were expensed or capitalised because these entities did not disclose that information; and

    (b) six entities did not fully disclose the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from E&E expenditure as required by IFRS 6.[4]

22. An academic study of the accounting for E&E expenditure considered a sample of 1,096 companies from eight countries.[5] The authors:

    (a) found entities apply very different accounting policies to E&E expenditure and the related disclosures were either absent or unclear in many instances;

    (b) said, in their view, the lack of sufficient mandatory disclosure requirements in IFRS 6 leads to a lack of transparency which hinders comparability; and

[3] Abdo, Hafez (2016), 'Accounting for Extractive Industries: Has IFRS 6 Harmonised Accounting Practices by Extractive Industries?', *Australian Accounting Review*, 26 (4), 346-59. 110 out of 118 companies in the sample were listed on the London stock exchange (15 FTSE 350 companies and 95 listed on the Alternative Investment Market). The rest of the sample included companies listed on the Hang Seng, Toronto and Irish stock exchanges and Fortune.

[4] Poswal, D. and P.Chauhan (2021), 'Do Oil and Gas Companies Comply with Requirements of IFRS 6? Evidence from India and Global Companies', *Journal of Asian Finance, Economics and Business,* 8 (3), 399-409.

[5] Constantatos, A., Dionysiou, D., Slack, R.,Tsalavoutas, I. and F.Tsoligkas (2021), 'The Capitalisation of Intangibles Debate: Accounting for Exploration and Evaluation Expenditure in Extractive Activities', *ACCA and Adam Business School Research Report*. The sample was from eight countries (Australia, Canada, India, South Korea, Norway, Russia, South Africa and the UK) for the period 2018.

(c) said it was unclear as to how entities determine the unit of account to test E&E assets for impairment.[6]

23. The authors recommended defining permitted accounting policies and requiring entities to disclose information that would allow users to understand how entities apply those policies in practice and how they test E&E assets for impairment.

24. One academic study examined the usefulness (value relevance) of disclosures about non-financial information (estimates of mineral resources/drilling results) and financial information (capitalised E&E expenditure) by estimating the association of the information disclosed with entities' share price and controlling for other factors that influence price.[7] The study used information disclosed by 294 hard-rock explorers in Australia from 2006–2012. The authors found:

(a) information about capitalised E&E expenditure was value relevant only when supported by information on geological milestones;

(b) when the financial and non-financial information were not disclosed simultaneously, whichever disclosure was provided first was more value relevant; and

(c) users utilise non-financial information to assess financial information regarding future economic benefits.

25. The evidence highlights users compare financial and non-financial disclosures to identify possible signals of success and are able to distinguish between E&E assets that reflect future economic benefits and E&E assets that simply reflect past expenditure. The authors also said their results should not be interpreted as suggesting that users do not understand capitalisation is permitted even when there is high uncertainty regarding whether the expenditure will generate future economic benefits.

26. Several studies that were included in an academic literature review paper found that various factors influenced the extent and quality of financial information entities in

[6] IFRS 6 requires entities to determine an accounting policy for allocating E&E assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment.

[7] Ferguson, A., S.Kean and G.Pundrich (2020), 'Factors Affecting the Value-Relevance of Capitalized Exploration and Evaluation Expenditures under IFRS 6', *Journal of Accounting, Auditing and Finance* 1-24.

the extractive industry voluntarily disclosed. These factors included, for example, leverage, listing status, size and ownership concentration.[8]

Review of other requirements and proposals to provide information about E&E expenditure and activities

27. We reviewed a selection of accounting standards, guidance and regulatory requirements for E&E expenditure and activities from several countries, including:

    (a) Australia—AASB 6 *Exploration for and Evaluation of Mineral Resources*, AASB 1022 *Accounting for the Extractive Industries* (now withdrawn), ASX Listing Rules Chapter 5 *Additional Reporting on Mining and Oil and Gas Production and Exploration Activities*, ASX Listing Rules Guidance Note 31 *Reporting on Mining Activities* and ASX Listing Rules Guidance Note 32 *Reporting on Oil & Gas Activities*;

    (b) China—Accounting Standard for Business Enterprises No.27 *Extraction of Oil and Natural Gas*;

    (c) India—*Guidance Note on Accounting for Oil and Gas Producing Activities (for entities to whom Ind AS is applicable)*;

    (d) United Kingdom—Statement of Recommended Practice *Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities* (now withdrawn); and

    (e) United States—FASB Accounting Standards Codification® 932 *Extractive Activities – Oil and Gas* and US Securities and Exchange Commission *Industry Guides*.

28. We also reviewed the Discussion Paper *Extractive Activities* published by the IASB in 2010 and the Issues Paper *Extractive Industries* published by the IASB's predecessor, the International Accounting Standards Committee, in 2000.

29. The accounting standards, guidance and regulatory requirements we reviewed are generally more prescriptive than IFRS 6 for the recognition and measurement of E&E

[8] Gray, S., N.Hellman and M.Ivanova (2019), 'Extractive Industries Reporting: A Review of Accounting Challenges and the Research Literature', *Abacus*, 55 (1), 42-91.

expenditure and activities. For example, applying US GAAP oil and gas entities account for E&E expenditure using either the ‘successful efforts’ or ‘full cost’ methods.[9] For entities applying the ‘successful efforts’ method, ASC 932 requires geological and geophysical costs to be expensed. Similarly, the UK SORP required entities applying the ‘successful efforts’ method to carry out impairment tests on a field-by-field basis, unless two or more fields use common production and transportation facilities. Accordingly, some of the underlying issues that give rise to stakeholders requesting better disclosures for E&E expenditure and activities would be (or would have been) less applicable in those jurisdictions.

30. Nonetheless, we found some examples of disclosure requirements for E&E expenditure and activities that were similar to the disclosure suggestions identified from prior research (see paragraphs 3–18). These included, for example, requirements to disclose:

(a) the basis under which cost pools for full cost accounting are established, for example geographic area, region or country (UK SORP);

(b) basis of determination of the cash-generating unit for impairment testing (India Guidance Note);

(c) the amount of exploratory well costs that have been capitalised for a period greater than one year after the completion of drilling, the number of projects for which the costs relate to and an aging of those amounts by year (US GAAP ASC 932);

(d) the amount of exploration and appraisal costs incurred in the period, whether expensed or capitalised, split by geographical area (UK SORP);

[9] This section refers to ‘successful efforts’ and ‘full cost’ methods of accounting for E&E expenditure. IFRS 6 does not define or describe these methods and different standards may have different definitions or requirements associated with those methods. However, broadly these terms have the following meaning:

(a) Successful efforts—only exploration and evaluation expenditure associated with successfully locating new minerals or oil and gas reserves is capitalised; costs are generally accumulated by well and are initially deferred to the balance sheet until the results of drilling are known; and

(b) Full cost—all exploration and evaluation expenditure incurred is capitalised, regardless of whether new minerals or oil and gas reserves are located; costs are accumulated into large cost pools, for example by country.

(e) the current status of significant properties or projects involved when an entity uses the full cost method (US SEC); and

(f) quarterly reports containing a summary of exploration activities and a summary of expenditure incurred on these activities (ASX Listing Rules).

31. We also found some examples of disclosure requirements for E&E expenditure and activities that were additional to the disclosure suggestions identified from our prior research (see paragraphs 3–18). These included, for example, requirements (or proposals) to disclose:

(a) a list of rights to explore or extract ‘minerals’ or ‘petroleum’ including location and participating interest (ASX Listing Rules);

(b) an explanation that recoverability of the carrying amount of the E&E assets (for an entity that recognises E&E assets) is dependent on successful development and commercial exploitation, or alternatively, sale of the respective area of interest (AASB 6);

(c) the fair market value of mineral properties held for exploration (IASC Issues Paper);

(d) extent of management discretion about timing of exploration activity if exploration costs are charged to expense (IASC Issues Paper);

(e) number of exploratory wells in progress at period end (IASC Issues Paper); and

(f) exploration cash flow time series disaggregated by geography and commodity (Discussion Paper).

Summary

32. Our review of prior research, academic evidence, and other requirements and proposals identified three broad categories of information about E&E expenditure and activities to consider further in Agenda Paper 19B:

(a) information to help understand the accounting for E&E expenditure;

(b) information to help compare entities with different accounting policies for E&E expenditure; and

(c) information to help understand the risks and uncertainties of E&E activities.

33. As explained in Agenda Paper 19, Agenda Paper 19B summarises findings from our review of a sample of entities' annual filings to understand what information entities disclose about these categories of information and Agenda Paper 19C analyses the findings in this agenda paper and Agenda Paper 19B.

Appendix—Suggestions we decided not to consider further

A1. Stakeholders provided other suggestions of information they said could be useful. However, we did not consider these suggestions further for various reasons:

(a) the disclosure suggestion relates to information that is already required. For example, E&E expenditure incurred during the period.

(b) the disclosure suggestion does not relate to E&E expenditure and activities—several disclosure suggestions were made about other extractive activities, for example:

(i) costs to extract;

(ii) breakeven prices for minerals; and

(iii) better disclosures about joint arrangements.

(c) the disclosure suggestion relates to reserve and resource information which the IASB decided in its September 2021 meeting not to explore further.

(d) the disclosure suggestion was not exclusively about E&E expenditure and activities—although the suggestion could relate to E&E expenditure and activities, the topic is wider and considering the suggestion would broaden the scope of the project, for example:

(i) one national standard-setter said users in their jurisdiction suggested more information be provided to help users assess the cash flow effects of streaming arrangements.[10] Although these arrangements can be entered into during the E&E phase, they are also entered into and affect other phases.

(ii) one national standard-setter said users in their jurisdiction ask for information about the life of mines because this information is helpful in assessing a project's value. While this could be relevant for E&E phase projects, it would also be relevant for projects in the development and production phases.

[10] A streaming arrangement is an agreement that provides, in exchange for an upfront deposit payment, the right to purchase all or a portion of a mine's production, at a price determined by the purchase agreement.

(e) the disclosure suggestion relates to information that is, in our view, better placed outside the financial statements, for example:

   (i) information about key performance indicators such as success rates of exploration and finding costs; and

   (ii) water availability and the cost of water resources.

(f) the disclosure suggestion relates to a narrow concern which is unlikely to make a significant improvement, for example one national standard-setter said entities should disclose the time period E&E expenditure has been carried forward.