

6 September 2004

Mr Colin Fleming  
International Accounting Standards Board  
30 Cannon St  
London EC4M6XH  
UNITED KINGDOM

Dear Sir,

**Issue for Comment on ED 6 – “Exploration for and evaluation of mineral resources” (ED 6) - Level at which impairment is assessed**

I am writing on behalf of Australian Institute of Company Directors (AICD) to express our views on the International Accounting Standards Board’s considerations of the responses it has received on ED 6.

Australian Institute of Company Directors is the peak organisation representing the interests of company directors in Australia. Current membership is over 19,000 drawn from large and small organisations, across all industries, and from private, public and the not-for-profit sectors. Australian Institute of Company Directors has had a standing policy committee focusing on financial and other reporting issues for over twenty years.

Australian Institute of Company Directors agrees with the IASB’s June 2004 decision that an entity should assess an exploration and evaluation asset for impairment when specific facts and circumstances indicate that the carrying amount of such an asset exceeds its recoverable amount. Australian Institute of Company Directors also concurs with the IASB’s decision to modify the requirement to test for impairment with respect to exploration and evaluation assets where there is insufficient data to make a proper, informed assessment of recoverable amount.

**Summary of Issue**

International Accounting Standard 36 (IAS 36), paragraph 22 requires impairment to be assessed at the individual asset level “unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets”. In addition, IAS 36 paragraph 70 requires that “if an active market exists for the output produced by an asset or a group of assets, that asset or group of assets shall be identified as a cash generating unit...”. In some cases in which exploration and evaluation assets are recognised, for example, in the petroleum sector, each well is capable of producing future cash inflows that are observable and capable of reliable measurement because there is an active market for crude oil. The IASB is concerned that respondents might not have appreciated this application requirement fully.

## **Australian Institute of Company Directors' Response**

Australian Institute of Company Directors agrees with the IASB's concern that IAS 36 may force entities recognising exploration assets to test impairment at a very low level. It is preferable for the IASB to state specifically within the standard that IAS 36 is applied on an "area of interest" basis, when testing impairment of exploration and evaluation assets.

The area of interest is an individual geological area that 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. An example is an oil field that covers three petroleum permits. A number of exploration wells have been drilled to determine the size, nature and extent of the oil reserves. Australian Institute of Company Directors considers that it is most appropriate to test impairment for the collective costs incurred in relation to the field, which would cover the three petroleum permits, rather than testing impairment by the individual wells drilled.

The "area of interest" approach reflects the economic substance of the exploration and evaluation activities as each well is drilled to provide further information regarding the extent of the resource rather than for specific production purposes. In addition, an area of interest should not be restricted to an individual petroleum permit. Where an oil or gas reserve covers three permit areas the field is developed and exploited as one asset rather than as three separable assets. Generally production wells are drilled based upon the information gained from initial exploration wells.

In determining impairment triggers that apply AICD recommends that an additional trigger be included within the standard, being where the entity divests itself of the area of interest or "farms it out". Where the entity has decided to divest itself or farm-out an area of interest, it must be able to determine a value at which it is willing to dispose or farm-out the area. For this reason these situations should be included with the triggers for impairment testing of areas of interest.

Australian Institute of Company Directors considers that clarifying within the standard that IAS 36 applies to exploration and evaluation assets on an area of interest basis, will ensure that exploration and evaluation assets are not overstated, nor impose an unreasonable burden upon industry upon transition to International Financial Reporting Standards.

If you have any questions in connection with this letter please contact Rob Elliott or Catherine Maxwell.

Yours faithfully,

Rob Elliott

**Policy Manager**

C.C. Australian Accounting Standards Board