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Project	**Extractive Activities**		
Paper topic	Matters in the scope of IFRS 6		

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Objective

1. This paper addresses matters in the scope of IFRS 6 *Exploration for and Evaluation of Mineral Resources*. IFRS 6 applies to exploration and evaluation (E&E) expenditure[1]. Consequently, this paper addresses matters that are relevant only to entities with extractive activities.

2. The objective of this paper is to present staff analysis and recommendations about whether the Board should include these matters within the scope of a project on extractive activities.

Overview

3. This paper is structured as follows:

   (a) Summary of staff analysis and recommendations (paragraphs 6–9);

   (b) Background (paragraphs 10–27);

   (c) Structure of staff analysis (paragraphs 28–32);

[1] Appendix A of IFRS 6 defines E&E expenditure as expenditure incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

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(d) Diversity of accounting policies applied (paragraphs 33–70);

(e) Comparison of intangible E&E expenditure to research and development expenditure (paragraphs 71–75);

(f) Impairment (paragraphs 76–96); and

(g) Disclosures about E&E expenditure and activities (paragraphs 97–110).

4. There are four appendices to this paper:

(a) Appendix A—Extracts from IFRS 6;

(b) Appendix B—2010 *Extractive Activities* Discussion Paper;

(c) Appendix C—Summary of outreach and research activities; and

(d) Appendix D—Summary of targeted investor outreach.

5. The appendices reproduce relevant excerpts from IFRS Standards or summarise information previously presented to the Board[2] and have been included for ease of reference.

Summary of staff analysis and recommendations

6. Through outreach and research, we identified the following matters:

(a) diversity in accounting for E&E expenditure (paragraphs 33–70). In particular:

(i) the unit of account applied (paragraphs 35–47); and

(ii) the elements of cost of an E&E asset (paragraphs 48–65)—that is:

1. which E&E expenditure to capitalise; and
2. when to start and stop capitalising E&E expenditure;

(b) differences in accounting for intangible E&E expenditure (applying IFRS 6) and the accounting for research and development (R&D) expenditure (applying IAS 38 *Intangible Assets*) (paragraphs 71–75);

[2] With the exception of Appendix D which is presented in ***Agenda Paper 19*** of this meeting.

(c) the impairment of E&E assets (paragraphs 76–96); and

(d) disclosures about E&E expenditure and activities (paragraphs 97–110).

7. Primary users of financial statements (users) that we engaged with said:

(a) information about E&E expenditure and activities is important. However, they do not view the diversity in accounting for E&E expenditure as significant.

(b) improving disclosures about an entity's E&E expenditure and activities would be more helpful than developing requirements to address the other matters listed in paragraph 6. A few stakeholders, other than users, also said improving disclosures would improve financial statement comparability.

8. Many members at the March 2021 Accounting Standards Advisory Forum (ASAF) meeting also said, based on their outreach, there are no significant issues with IFRS 6 or indications that a project on extractive activities should be a high priority. Preparers said it is helpful that IFRS 6 permits alignment of E&E expenditure accounting policies with industry peers.

9. Based on our analysis in this paper, we recommend that the Board:

(a) explore developing requirements or guidance to improve disclosures about an entity's E&E expenditure and activities as part of a project on extractive activities; and

(b) not address other matters identified in this paper as part of that project. We think there is insufficient evidence at this stage to support making significant amendments to the recognition and measurement of E&E expenditure and assets.

Background

10. IFRS 6 applies to expenditure incurred in the exploration for and evaluation of mineral resources and is therefore relevant only to entities with extractive activities. In particular:

(a) IFRS 6 exempts entities from applying particular parts of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing their accounting policies. This permits entities with extractive activities adopting IFRS Standards to continue to apply some aspects of their pre-existing accounting policies to E&E expenditure; and

(b) requires the application of paragraph 20 of IFRS 6 rather than paragraphs 8–17 of IAS 36 *Impairment of Assets* when identifying an E&E asset that may be impaired.

11. The Extractive Activities research project aims to gather evidence to help the Board decide whether to start a project to develop proposals on accounting requirements that would amend or replace IFRS 6. The project has occurred in multiple stages since its commencement in 2018 as follows:

(a) Stage 1—review of 2010 *Extractive Activities* Discussion Paper (Discussion Paper);

(b) Stage 2—outreach and research activities; and

(c) Stage 3— targeted investor outreach.

12. The following paragraphs summarise key messages from these different stages.

Proposals in the Discussion Paper

13. In relation to matters in the scope of IFRS 6, the Discussion Paper proposed requirements regarding:

(a) the unit of account to be applied when accounting for E&E expenditure;

(b) the recognition of E&E expenditure;

(c) the measurement of an E&E asset; and

(d) the impairment of an E&E asset.

14. Appendix B provides further details on, and summarises feedback regarding, these proposals.

Key messages from outreach and research

15. Stakeholders, in particular national standard-setters, said the flexibility permitted by IFRS 6 has resulted in entities developing diverse accounting policies to account for E&E expenditure and this is one of the reasons for a lack of comparability between those entities' financial statements.

16. Further outreach and research (including a review of academic evidence) confirmed the diversity in accounting for E&E expenditure. For example, we identified the following accounting policy methods applied:

    (a) capitalisation—area of interest (E&E expenditure is accounted for by area of interest)[3];

    (b) capitalisation—full cost (all E&E expenditure 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);

    (c) capitalisation—successful efforts (only E&E 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);

    (d) capitalisation—unknown (no specific accounting policy method, such as those listed in (a)-(c), was disclosed. These policies may provide details of how the costs are accumulated and may in some cases be equivalent of one of those three accounting policy methods);

    (e) expense—as incurred (all E&E expenditure is expensed as incurred including property acquisition costs); and

[3] Paragraph Aus7.3 of the Australian Accounting Standard AASB 6 *Exploration for and evaluation of Mineral Resources* defines an area of interest as an individual geological area in which the presence of a mineral deposit or an oil or natural gas field is considered favourable or has been proved to exist. It is common for an area of interest to contract in size progressively, as E&E activities lead towards the identification of a mineral deposit or an oil or natural gas field, which may prove to contain economically recoverable reserves. When this happens during the E&E of mineral resources, E&E expenditures are still included in the cost of the E&E asset notwithstanding that the size of the area of interest may contract as the E&E operations progress. In most cases, an area of interest will comprise a single mine or deposit or a separate oil or gas field.

(f) expense—subsequent expenditure as incurred (all E&E expenditure is expensed as incurred excluding property acquisition costs which are capitalised).

17. Outreach and research showed stakeholders have mixed views on the appropriate accounting for E&E expenditure and the existing diversity is primarily due to judgements applied in determining:

(a) the appropriate unit of account; and

(b) the elements of cost of an E&E asset—that is:

(i) which E&E expenditure to capitalise; and

(ii) when to start and stop capitalisation.

18. In addition to the matters identified in paragraph 17, we also identified:

(a) accounting for E&E expenditure and R&D expenditure—a few stakeholders said E&E expenditure that is intangible in nature (intangible E&E expenditure) is similar to R&D expenditure accounted for applying IAS 38 and therefore, the two should be accounted for consistently.

(b) impairment of E&E assets—some stakeholders requested guidance on how an entity applies IAS 36 and the requirements in paragraphs 18–22 of IFRS 6 to E&E assets (Appendix A); and

(c) disclosures—many stakeholders suggested improving disclosures about an entity's E&E expenditure and activities.

19. We also conducted outreach with a range of stakeholders to better understand how useful users find information about E&E expenditure and whether users ask for other information to help them understand an entity's E&E expenditure and activities. For example, we asked preparers whether:

(a) users ask for information about the accounting for E&E expenditure;

(b) users ask for information about E&E expenditure and activities not specifically required by IFRS Standards, and if so, what information; and

(c) they disclose information about E&E expenditure and activities not specifically required by IFRS Standards, and if so, what information.

20. A few national standard-setters also provided feedback about how users in their jurisdictions manage any differences in accounting for E&E expenditure.

21. Outreach indicated that users did not view differences in accounting for E&E expenditure as significant. For example:

    (a) most users said information outside financial statements, such as information about an entity's reserves and resources and sustainability measures, is more important than information about E&E expenditure;

    (b) many preparers said, at the request of users, they provide information not specifically required by IFRS Standards, such as non-GAAP and cash measures, rather than information about E&E expenditure because their users find this information more useful;

    (c) some preparers said users do not request additional information about how they account for E&E expenditure; and

    (d) a few national standard-setters said users in their jurisdiction are able to manage any diversity in accounting for E&E expenditure.

22. Targeted outreach with investors did not identify any compelling evidence suggesting users are materially affected by the differences in accounting for E&E expenditure. For example, one investor said the diversity is not significant because they looked at free cash flows and the extent of capitalisation of E&E expenditure is irrelevant to this measure.

23. Although many users said it would be helpful to limit the accounting policy choices an entity can apply, many said it would be better to instead improve disclosures about E&E expenditure and activities (including disclosures about the accounting policy applied). For example, one investor said trying to limit the accounting policy choices for E&E expenditure would be a major undertaking and would likely not result in an outcome that would be widely supported by all investors.

24. Some users also said information about E&E expenditure is most important when analysing entities with E&E expenditure that is material to their financial statements (such as entities engaged only in E&E activities).

25. Outreach indicated that disclosures about an entity's E&E expenditure and activities could be improved, for example:

    (a) information about the accounting policies applied is often not detailed enough for users to understand the accounting for E&E expenditure; and

    (b) information about the level at which E&E assets are tested for impairment is often not detailed enough for users to understand the judgements made (and the rationale for those judgements) when testing for impairment.

26. Users also provided examples of information they would find useful, but are not specifically required by IFRS Standards:

    (a) a reconciliation of E&E assets (similar to that required by IAS 16 *Property, Plant and Equipment* for an item of property, plant and equipment), allowing users to understand the E&E expenditure incurred, expensed, capitalised and impaired during a reporting period;

    (b) a breakdown of E&E expenditure by project or area of interest;

    (c) cash spent on E&E activities during a reporting period;

    (d) the accounting policies for E&E expenditure and management's reasons for applying those policies; and

    (e) a summary of the progress of each active exploration project, including risks—for example, a few users said information about the type of E&E activities an entity engaged in during the reporting period would be useful.

27. Appendices C and D provide further details on these matters.

Structure of staff analysis

28. The following section summarises the structure of our analysis of matters in the scope of IFRS 6 applying the five assessment factors[4].

29. As highlighted in paragraph 1, this paper considers only matters related to E&E expenditure. All matters discussed are therefore in the scope of IFRS 6 and affect only

[4] Refer to ***Agenda Paper 19B*** of this meeting for discussion on the assessment factors.

entities with extractive activities. Accordingly, we have not considered these factors separately for each matter.

30. Paragraphs 19–26 summarise the effects of the matters on users. We have not assessed this factor separately for each matter because the feedback from users on these matters is interconnected and we did not ask specific questions about each individual accounting matter.

31. The remaining assessment factors—that is, whether the matter gives rise to diversity in the treatment of similar transactions and whether the matter is one for which the Board can significantly improve accounting (including disclosure)—have been considered separately for each of the matters identified as follows:

    (a) diversity of accounting policies developed applying IFRS 6 (paragraphs 33–70):

        (i) unit of account;

        (ii) elements of cost of an E&E asset;

    (b) comparison of intangible E&E expenditure to R&D expenditure (paragraphs 71–75);

    (c) impairment of E&E assets (paragraphs 76–96); and

    (d) disclosures about an entity's E&E expenditure and activities (paragraphs 97–110).

32. In analysing each matter and reaching a staff recommendation, we considered all five assessment factors.

Diversity of accounting policies applied

33. Outreach and research indicated that the diversity in accounting for E&E expenditure is primarily due to judgements applied in determining:

    (a) the appropriate unit of account; and

(b) the elements of cost of an E&E asset—that is:

(i) which E&E expenditure to capitalise; and

(ii) when to start and stop capitalisation.

34. We considered these matters together because they are interdependent and we think reducing the diversity in accounting for E&E expenditure would require simultaneously addressing these matters.

Unit of account[5]

Description of the matter

35. IFRS 6 does not specify requirements for determining the unit of account to apply when accounting for E&E expenditure. Consequently, an entity applies judgement to determine the most appropriate unit of account (unless a national standard-setter or regulator requires the use of a specific unit of account) and may refer to the *Conceptual Framework for Financial Reporting* when doing so.

Diversity—does the matter give rise to diversity in the accounting for similar transactions?

36. Outreach and research identified a range of units of account being applied to E&E expenditure. These included, but were not limited to:

(a) oil or gas well;

(b) oil or gas field;

(c) exploration area;

(d) block area;

(e) license;

(f) service contract;

(g) project;

[5] Paragraph 4.48 of the *Conceptual Framework for Financial Reporting* defines '**unit of account**' as the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition and measurement concepts are applied.

(h) property;

(i) prospect;

(j) geological area of interest; and

(k) geographic area of interest.

37. We agree with the project team's view in the Discussion Paper that unit of account is a matter which gives rise to diversity in accounting for E&E expenditure. This is because, for accounting policy methods that capitalise all or part of E&E expenditure, different units of account could lead to, for example, similar items (such as a legal right) being accounted for differently (as an individual legal right, or grouped together with other legal rights). Different units of account could also lead to different outcomes when testing E&E assets for impairment (see paragraph 76(d)).

38. However, we also think some of the diversity likely reflects facts and circumstances of individual entities. That is, differences in judgements applied could reflect the different ways entities manage their E&E expenditure and activities.

Improvements—is the matter one for which the Board can significantly improve accounting (including disclosure)?

39. Consistent with findings from outreach and research, we think developing requirements or guidance about the unit of account could reduce diversity. As suggested by some stakeholders, the Board could:

(a) develop requirements that would help an entity determine which unit of account would provide the most useful information—for example, the Board could:

(i) identify and define commonly applied units of account so that entities consistently apply these units of account; or

(ii) develop guidance about the factors an entity considers when determining the most appropriate unit of account.

(b) require entities to apply one or more specified units of account—for example, the Discussion Paper proposed applying a single unit of account because it would improve the usefulness of information about an entity's

extractive activities. Although most stakeholders generally agreed with the proposal, they also asked for application guidance.

40. When considering whether the accounting for E&E expenditure can be improved by addressing the unit of account, we think it is necessary to consider:

(a) interaction with other IFRS Standards (paragraphs 41–42);

(b) interaction with jurisdictional regulatory requirements (paragraph 43);

(c) relevance of information (paragraphs 44–45); and

(d) resource commitment (paragraphs 46–47).

Interaction with other IFRS Standards

41. In March 2018 the Board issued the revised *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*) which includes concepts that can be used when determining an appropriate unit of account. Any requirements or guidance about unit of account would need to consider these concepts.

42. Additionally, some stakeholders said E&E expenditure that is intangible in nature (intangible E&E expenditure) is similar to R&D expenditure, and E&E expenditure that is tangible in nature is similar to property, plant and equipment. One national standard-setter highlighted that developing requirements specifying the unit of account for E&E expenditure could result in unintended consequences for transactions accounted for applying IAS 16 and IAS 38.

Interaction with jurisdictional regulatory requirements

43. Outreach and research showed that some national standard-setters and regulators specify the unit of account to be applied. For example, entities applying the Australian Accounting Standard AASB 6 are required to use an individual geological area of interest as the unit of account when accounting for E&E expenditure. Accordingly, any requirements or guidance developed could duplicate, or conflict with, existing jurisdictional regulatory requirements. Additionally, developing specific requirements that are not aligned with other requirements could increase diversity between industry peers. For example, some entities develop accounting policies for E&E expenditure that align with US GAAP requirements—developing requirements that would not permit entities to do so could affect the comparability of financial statements within

the industry because entities applying IFRS Standards would no longer be able to develop accounting policies aligned with industry peers applying US GAAP.

Relevance of information

44. Most users said although information about E&E expenditure and activities is important, diversity in accounting for E&E expenditure is not a significant concern. However, a few users said information about management's judgements in making accounting policy choices and understanding the reasons for those choices could provide useful information. For example, we understand that entities generally:

    (a) apply units of account which are most appropriate in the context of the extractive activities in which they are engaged, where they are engaged in those activities (for example, geographical location and geological area of those activities) and the sub-industry in which they operate. That is, entities apply judgement to select a unit of account that reflects relevant facts and circumstances.

    (b) refine the unit of account as a result of E&E activities. That is, at the start of a project, an entity might apply a unit of account that is large (such as a large geographical location) and as E&E activities continue, the entity refines the unit of account to suit relevant facts and circumstances so that, by the time the entity moves to the development phase, the unit of account is generally specific to a single mine, or oil or gas field or well.

45. Should the unit (or units) of account be standardised, entities may be forced to apply a unit of account which does not reflect relevant facts and circumstances, thus reducing the usefulness of information.

Resource commitment

46. Should the Board develop requirements or guidance about the unit of account, we think further research would be required to:

    (a) identify which units of account entities predominantly apply and why;

    (b) what the most appropriate unit, or units, of account would be and if the unit, or units, of account should be consistent for all entities with extractive activities (for example, whether entities in the oil and gas industry should

apply the same unit of account as that applied by entities in the minerals industry);

(c) identify and consider any conflicts with jurisdictional regulatory requirements; and

(d) reduce the risk of unintended consequences on the application of other IFRS Standards such as IAS 16 and IAS 38.

47. Additionally, the Board would also need to consider whether specialist expertise might be needed to help research and/or define specific units of account.

Elements of cost of an E&E asset

Description of the matter

48. Outreach and research identified differences in how entities determine the elements of cost of an E&E asset—in particular, they identified differences in how entities determined:

(a) which E&E expenditure entities capitalise; and

(b) when to start and stop capitalisation.

Diversity—does the matter give rise to diversity in the accounting for similar transactions?

49. Outreach and research indicated that entities with extractive activities apply judgements about:

(a) the point at which to start capitalising E&E expenditure—for example, stakeholders have differing views about whether to:

(i) start capitalising from the point of acquiring the legal rights to explore;

(ii) start capitalising at some pre-determined point after the legal rights to explore have been acquired; or

(iii) capitalise at all (that is, if all E&E expenditure should be expensed).

(b) the point at which to stop capitalising E&E expenditure—for example, stakeholders have differing views about:

   (i) whether to stop capitalising after the legal rights have been acquired (that is, to capitalise only the cost of acquiring the legal rights to explore); and

   (ii) the point at which technical feasibility and commercial viability of extracting a mineral resource are demonstrable[6].

(c) which costs, other than those listed in paragraph 9 of IFRS 6 (Appendix A), to capitalise—for example:

   (i) borrowing costs incurred for the purpose of E&E activities (that is, the interaction between IFRS 6 and IAS 23 *Borrowing Costs*); and

   (ii) overheads (that is, whether overhead expenditure incurred to support E&E activities can be capitalised).

(d) whether all costs listed in paragraph 9 of IFRS 6 should be capitalised—for example, some entities capitalise geological and geophysical expenditure as part of their E&E assets and some expense it.

50. We have not researched the matters in paragraph 49. That is, research has identified only that 'elements of cost of an E&E asset' are a source of diversity but we have not researched further why entities may apply different judgements for these matters. For example, we are unable to assess whether the different judgements reflect differing facts and circumstances or whether entities apply different judgements to similar facts and circumstances.

51. However, almost all oil and gas entities we sampled commenced capitalisation of E&E expenditure from the point of acquiring legal rights, and many minerals entities also applied a similar accounting policy method (Appendix C). We acknowledge there can still be diversity within these similar accounting policy methods (for example, which E&E expenditure to capitalise and what unit of account to apply), but we also

[6] Paragraph 17 of IFRS 6 requires an entity to no longer classify an E&E asset as such when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

observed that the extent of any diversity of when (and if) capitalisation commences is, particularly for oil and gas entities, limited.

Improvements—is the matter one for which the Board can significantly improve accounting (including disclosure)?

52. Consistent with findings from outreach and research, we think the Board could help entities apply more consistent judgements about what costs to capitalise as part of an E&E asset or reduce the available accounting policy choices. This could be done through developing requirements or guidance clarifying:

    (a) when to start capitalising E&E expenditure (paragraphs 53–59);

    (b) when E&E activities have concluded—that is, defining 'technical feasibility and commercial viability' in IFRS 6 (paragraphs 60–63); and

    (c) which E&E expenditures to capitalise (paragraphs 64–65).

Clarifying when to start capitalising E&E expenditure

53. We think that the Board could specify that entities should:

    (a) recognise all E&E expenditure as an asset until an entity obtains sufficient information that confirms whether commercial quantities of oil and gas or minerals exist (option one); or

    (b) recognise E&E expenditure as an asset only when specific criteria are met (option two).

54. We discuss the two options in more detail below. However, the Board would need to conduct further research to determine the most appropriate option (or whether other options[7] exist that could be more appropriate).

Option One

55. As part of our research we observed that many entities appear to be applying similar accounting policy methods to option one and therefore such an approach could be less

[7] For example, another possible option could be to not permit capitalisation of any E&E expenditure. This would also reduce accounting policy choices and could address concerns about whether E&E expenditure meets the definition of an asset. However, it could also result in greater disruption than option one (as explained in paragraph 59) and the outcome of applying this option might not reflect the facts and circumstances.

disruptive than option two. This option could also reduce accounting policy choices and improve financial statement comparability because it would require entities to, at least initially, capitalise all E&E expenditure.

56. The Discussion Paper proposal regarding the point at which to start capitalising E&E expenditure (see paragraph B5 of Appendix B) was similar to option one. However, almost all respondents to the Discussion Paper disagreed with the proposal to recognise all E&E expenditure incurred subsequent to the acquisition of the legal rights as an asset (although our research observed that the revised 2018 *Conceptual Framework*, particularly changes regarding the definition of an asset since 2010, could change those views).

Option Two

57. Although most entities we sampled capitalised E&E expenditure from the point of acquiring the legal rights to explore, a few entities capitalised E&E expenditure from a later point. For example:

(a) a few capitalised only what they defined as 'evaluation expenditure' and expensed all 'exploration expenditure'; and

(b) a few entities started capitalising E&E expenditure only once it was more likely than not that the entity will realise economic benefits.

58. This option could provide useful information about a project. For example, depending on the criteria developed, the extent of capitalisation could provide useful information about the differing risks of different projects.

59. However, as explained in paragraph 55, this option could result in greater disruption for entities and it may be difficult to develop criteria that reflect all facts and circumstances. In addition, we think the Board could require entities to instead disclose some of the useful information that would result from applying this option (see paragraphs 97–110 for our analysis on disclosures).

Clarifying when E&E activities have concluded

60. Currently, an entity applies judgement to determine when the technical feasibility and commercial viability of extracting mineral resources are demonstrable—that is, the point at which E&E activities have been completed and development activities (which

are outside the scope of IFRS 6) commence. A few stakeholders requested guidance to help make this assessment. We think developing definitions for 'technical feasibility' and 'commercial viability' (or requirements or guidance clarifying the point at which capitalisation of E&E expenditure should stop) might reduce diversity.

61. However, we think the Board would need to understand and research the reasons for different judgements of when technical feasibility and commercial viability are demonstrable and whether those differences reflect differing facts and circumstances. For example, the point at which E&E activities are completed might be when:

    (a) an entity receives feasibility reports;

    (b) a project is approved for development; or

    (c) reserves or resources are established.

62. We think it would be difficult to capture these differences in any guidance or definitions.

63. We also think the Board would need to consider whether specialist expertise would be required given the specialised nature of the related activities.

Clarifying which E&E expenditures to capitalise

64. We think in order to reduce diversity the Board could develop additional requirements or guidance clarifying which E&E expenditures to capitalise. In particular, the Board could:

    (a) address specific matters identified—for example, matters regarding the interaction of IFRS 6 with other IFRS Standards (that is, whether entities should account for costs also in the scope of other IFRS Standards by applying those other IFRS Standards, or IFRS 6, or both); and

    (b) provide additional guidance or examples about types of expenditure that might be considered E&E expenditure and whether all these expenditures should be capitalised. Currently, paragraph 9 of IFRS 6 lists only a few examples (Appendix A).

65. However, only a few stakeholders highlighted these matters. We also think the Board would need to further research each of these matters to determine:

    (a) whether any diversity in accounting for these matters exists or whether any differences in accounting reflect differing facts and circumstances; and

    (b) whether any diversity in accounting materially affects users. Although we did not specifically ask users about these matters, none of the users we conducted outreach with raised these matters as being of concern.

Staff recommendation

66. Diversity in accounting for E&E expenditure (relating to unit of account and the elements of cost of an E&E asset) is relevant only to entities with extractive activities and to activities in the scope of IFRS 6.

67. Almost all users we conducted outreach with said information about E&E expenditure and activities is important. Although research and academic evidence confirms diversity in accounting for E&E expenditure, one academic study showed that immediately expensed E&E expenditure and capitalised E&E expenditure were both value relevant, suggesting that whether E&E expenditure is capitalised or expensed was not material to users[8].

68. We considered whether, as many stakeholders (including users) suggested, the Board should develop requirements or guidance to address this diversity. However, we have not identified compelling evidence to justify doing so. In particular:

    (a) although accounting policies developed applying IFRS 6 are diverse, research showed that entities in the same industry often developed accounting policies that align with their industry peers.

    (b) one academic study showed that E&E expenditure was not value relevant when entities deviated from methods commonly used by entities of the same size and in the same industry. In the researcher's view, the ability to

[8] Zhou, Birt and Rankin (2015), 'The value relevance of exploration and evaluation expenditures', *Accounting Research Journal*, 28 (3), 228-50.

develop the most appropriate accounting policy for E&E expenditure allowed entities to provide useful information[9].

(c) although almost all users said information about E&E expenditure and activities is important, many users also said:

(i) the accounting for E&E expenditure is not significant—for example, information about the amount of E&E expenditure incurred and the related E&E activities is more important than information about the accounting for E&E expenditure;

(ii) they are able to manage the existing diversity; and

(iii) instead of reducing the diversity, the Board should focus on improving disclosures about E&E expenditure and activities, including disclosures about the entity's accounting policy choices applying IFRS 6.

69. We also think that in developing any requirements or guidance, the Board would need to consider:

(a) interaction with other IFRS Standards—that is, the potential for unintended consequences on other IFRS Standards, such as IAS 16 and IAS 38.

(b) interaction with jurisdictional regulatory requirements (including jurisdictional accounting standards).

(c) resource commitment—that is, developing requirements or guidance to address these matters would require further outreach and research which may also require specialist expertise.

70. Based on our analysis, we do not have evidence at this stage to suggest that the benefits of exploring whether to develop any requirements or guidance would outweigh the costs. Accordingly, we recommend not addressing the diversity in accounting for E&E expenditure as part of a project on extractive activities. In particular we recommend not developing requirements or guidance to address:

(a) the unit of account to apply to E&E expenditure; and

[9] Power, Cleary and Donnelly (2017), 'Accounting in London Stock Exchange's extractive industry: The effect of policy diversity on the value relevance of exploration-related disclosures', *British Accounting Review*, 49 (6), 545-59.

(b) the elements of cost of an E&E asset—that is:

(i) which E&E expenditures to capitalise; and

(ii) when to start and stop capitalisation.

Question 1 for the Board
Does the Board agree with the staff recommendation in paragraph 70?

Comparison of intangible E&E expenditure to R&D expenditure

Description of the matter

71. A few stakeholders said intangible E&E expenditure is the same as (or similar to) R&D expenditure accounted for applying IAS 38. This is because, in their view, the risks associated with intangible E&E expenditure are the same as those associated with R&D expenditure. They asked why E&E expenditure is accounted for differently from R&D expenditure (Appendix C).

Diversity—does the matter give rise to diversity in the accounting for similar transactions?

72. We disagree with stakeholders who said intangible E&E expenditure and R&D expenditure are the same (or similar) and should therefore be accounted for consistently. We think intangible E&E expenditure and R&D expenditure are fundamentally different and accordingly, differing accounting treatments are justified. This is because, for example:

(a) entities incur E&E expenditure to determine whether something that exists (for example, a mineral reserve) can be extracted, refined and sold. Entities incur R&D expenditure for the purpose of developing goods or services that do not exist or that can be improved.

(b) unlike R&D expenditure, the cost and value of E&E expenditure is not correlated—that is, unlike an entity engaged in R&D activities, an entity with extractive activities is constrained by pre-existing markets and is unable to set the price of the minerals or oil or gas extracted.

73. Some stakeholders agreed with our view in paragraph 72. Although we did not specifically ask users about this matter, we note that users did not identify this as a concern. We also note that only a few stakeholders—some were not familiar with the extractive industries—questioned why E&E expenditure is accounted for differently to R&D expenditure.

74. Based on our analysis in paragraphs 72–73 we have not further analysed whether the Board should develop requirements to address this matter—that is, we have not considered whether the Board can significantly improve accounting for this matter.

Staff recommendation

75. Based on our analysis, we recommend not developing requirements to standardise the accounting for intangible E&E expenditure and R&D expenditure as part of a project on extractive activities.

Question 2 for the Board
Does the Board agree with the staff recommendation on paragraph 75?

Impairment

Description of the matter

76. Consistent with the difficulties noted in the Discussion Paper, some preparers and a few national standard-setters said IAS 36 can be difficult to apply to E&E assets despite the exceptions IFRS 6 provides from specific requirements in IAS 36 (Appendix A). These stakeholders said testing E&E assets for impairment can be difficult because:

    (a) it is difficult in some situations to determine the recoverable amount of E&E assets—for example, when exploration is not at an advanced enough stage, it is difficult to reliably calculate a value in use or fair value less costs of disposal. One national standard-setter said in practice, entities with extractive activities often conclude there are either no indicators of impairment or write-off the entire E&E asset.

(b) it is difficult to identify indicators of impairment for E&E assets (in addition to those listed in paragraph 20 of IFRS 6).

(c) it is difficult in some situations to determine how long E&E assets should remain on the balance sheet—for example, when an entity decides to defer the development of a mineral or oil and gas project for several years in favour of other projects.

(d) of the diversity regarding the unit of account applied to E&E expenditure and assets—for example, testing for the impairment of an E&E asset applying a large unit of account (such as by country) would significantly differ from testing for the impairment of an E&E asset using a smaller unit of account (such as by property). See paragraphs 35–47 for our analysis of this matter.

Diversity—does the matter give rise to diversity in the accounting for similar transactions?

77. Stakeholders said the difficulties noted in paragraph 76 have led to differences in how entities apply IAS 36. However, we think the source of these differences is the inherent uncertainty and risk associated with E&E activities. This uncertainty and risk often mean that entities need to make significant judgements when testing E&E assets for impairment, and these judgements necessarily reflect entity and project specific facts and circumstances.

Improvements—is the matter one for which the Board can significantly improve accounting (including disclosure)?

78. Notwithstanding our assessment in paragraph 77, we acknowledge the difficulties entities face in testing E&E assets for impairment and consider below whether the Board could develop requirements or provide guidance to address these difficulties.

79. The Discussion Paper suggested writing down an E&E asset to its recoverable amount only if management has enough information to make this determination. In the project team's view, management would have sufficient information to make this

determination only after completing (or nearly completing) E&E activities. As a result, the Discussion Paper proposed not applying IAS 36 to E&E assets.

80. Similarly, paragraphs BC36–BC39 of the Basis for Conclusions on IFRS 6 explain that the Board considered that in some cases E&E assets do not generate cash flows and there is insufficient information about the mineral resources in a specific area to make reasonable estimates of an E&E asset's recoverable amount. The Board decided that E&E assets need not be tested for impairment until information suggesting the asset might be impaired becomes available, and IFRS 6 suggests some possible indicators of impairment.

81. We think that, in order to help entities more consistently test E&E assets for impairment, the Board could explore whether it could develop requirements or guidance in addition to (or in lieu of) paragraphs 18–22 of IFRS 6 (Appendix A). For example, the Board could:

    (a) develop additional requirements or guidance (for example, illustrative examples) clarifying how to apply the requirements in both IAS 36 and paragraphs 18–22 of IFRS 6 in determining the recoverable amount of an E&E asset; or

    (b) identify and list indicators of impairment of E&E assets beyond those included in paragraph 20 of IFRS 6.

Developing requirements or guidance to help determine recoverable amount

82. We agree with the Discussion Paper and the Basis for Conclusions to IFRS 6 which acknowledge that unless E&E activities are at an advanced stage, an entity is unlikely to have sufficient information to reliably determine an E&E asset's recoverable amount.

83. For this reason, the project team proposed an alternative impairment approach in which an entity would:

    (a) write down the E&E asset when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable; and

    (b) apply a separate set of indicators to test whether the E&E asset can continue to be recognised.

84. However, most respondents to the Discussion Paper opposed the proposal because it:

(a) would create an exception to IAS 36;

(b) could result in overstating E&E assets and also delay the recognition of an impairment loss; and

(c) would place too much reliance on management judgement to identify when the carrying amount of the asset will not be recoverable, which could adversely affect financial statement comparability.

85. Consistent with the project team's view in the Discussion Paper, we think it would not be possible to develop requirements or guidance to help entities determine an E&E asset's recoverable amount. The principal reason that it is difficult to estimate these recoverable amounts is the inherent uncertainty and the lack of information during E&E activities. It is unlikely that additional requirements or guidance could resolve this fundamental issue.

86. We also agree with the Discussion Paper's explanation that entities may manage their E&E expenditure and activities differently and have different perceptions of how well those activities are progressing and accordingly, prescribing how an entity tests an E&E asset for impairment would be difficult.

87. Furthermore, as observed in the feedback to the Discussion Paper (discussed in paragraph 84), stakeholders were generally not supportive of creating further exceptions to IAS 36 or developing requirements or guidance that would place even more reliance on management judgements. We think the Board would also need to be mindful of any unintended consequences to the wider application of IAS 36. In our view, some of the judgements stakeholders highlighted could be similar to judgements entities in other industries have to make.

Developing additional indicators of impairment

88. One national standard-setter said preparers in their jurisdiction said there were challenges with identifying indicators of impairment for E&E assets. Another national standard-setter said the Board should assess the need to refine or provide further guidance on impairment indicators for E&E assets.

89. The Discussion Paper notes that the project team were unable to identify additional indicators that would be useful in predicting whether and when the carrying amount of an E&E asset is not recoverable. This was because if information about the presence of minerals or oil and gas is insufficient for predicting future cash flows, that information is likely to also be insufficient for any objective indicators of impairment.

90. We agree with the project team's view in paragraph 89. Although the Board could explore whether to develop a set of indicators to assess whether an entity can continue to recognise E&E assets rather than a set of impairment indicators (as was also suggested in the Discussion Paper), most respondents to the Discussion Paper disagreed with this approach because it would place too much reliance on management judgement.

91. In addition, the diversity in the units of account applied to E&E expenditure (discussed in paragraphs 35–47) could limit any improvements the Board could make (for example, the impairment indicators for a particular unit of account such as an oil field might not also be appropriate for a unit of account such as a country).

Staff recommendation

92. Impairment of E&E assets is relevant only to entities with extractive activities and to E&E assets in the scope of IFRS 6.

93. The primary benefit of developing requirements or guidance for the impairment of E&E assets would be to help entities make consistent judgements when testing E&E assets for impairment.

94. We think one of the primary reasons for the difficulties in testing E&E assets for impairment is the insufficiency of information for significant periods of E&E activities. Based on our analysis, we think it would be difficult to develop requirements or guidance to address this matter.

95. Although we did not specifically ask users about this matter, they did not identify this as being of concern. However, targeted outreach with users indicated that users wanted improved disclosures about how E&E assets are tested for impairment. One regulator also said disclosing information about the cash-generating units applied

when testing E&E assets for impairment would be useful. Paragraphs 97–110 analyse disclosures about E&E expenditure and activities.

96. Based on our analysis, we do not have evidence at this stage to suggest that the benefits of exploring whether to develop requirements or guidance to address this matter would outweigh the costs. Accordingly, we recommend not developing additional requirements or guidance for the impairment of E&E assets as part of a project on extractive activities.

Question 3 for the Board
Does the Board agree with the staff recommendation in paragraph 96?

Disclosures about E&E expenditure and activities

Description of the matter

97. Outreach identified that:

    (a) disclosures about E&E expenditure and activities could be improved; and

    (b) entities commonly provide information not required by IFRS Standards.

98. This section analyses some of the matters raised by stakeholders regarding disclosures about E&E expenditure and activities.

Diversity—does the matter give rise to diversity in the accounting for similar transactions?

99. Consistent with the analysis and proposals in the Discussion Paper, many stakeholders said entities with extractive activities often provide information not required by IFRS Standards. We understand there are also differences in the nature and quality of information disclosed by entities about their E&E expenditure and activities.

100. Outreach and research identified that it was not always possible for users to determine how an entity accounts for E&E expenditure. For example, research on the diversity in accounting for E&E expenditure identified that the accounting policy applied to E&E expenditure was not always clear.

101. In addition, one regulator said entities do not sufficiently disclose information about a number of key accounting policy choices including, for example, the accounting policy choice applied to determine when the E&E phase is completed and the cash-generating unit used for impairment testing. One user in the targeted outreach said disclosures about how management tests E&E assets for impairment are often not detailed enough for users to be able to understand the judgements management has made when testing E&E assets for impairment.

Improvements—is the matter one for which the Board can significantly improve accounting (including disclosure)?

102. We think differences in the nature and quality of disclosures discussed above could result from inconsistent application of IFRS Standards. However, it could also indicate that the disclosure requirements of IFRS 6 (Appendix A) are not sufficient to meet users' needs. For example, one national standard-setter said IFRS 6:

    (a) does not require specific disclosures which would enable users to understand the risks and uncertainties about E&E activities; and

    (b) requires fewer disclosures about E&E activities than are generally required for other activities. In this national standard-setter's view, this was because IFRS 6 was intended to be temporary.

103. Users, including from our targeted outreach, provided the following examples of information not specifically required by IFRS Standards that would, in their view, be useful:

    (a) a reconciliation of the opening and closing balance of E&E assets (similar to that required for an entity's property, plant and equipment) allowing users to understand E&E expenditure expensed, capitalised and/or written-off in a reporting period as well as cumulative spend to date;

    (b) a breakdown of E&E expenditure by project or area of interest;

    (c) cash spent on E&E activities for a reporting period;

    (d) choices made in developing accounting policy for E&E expenditure and reasons for those choices; and

(e) information about the progress of each active E&E project, including risks which could affect a project's success—a few users said information about the type of E&E activity is information they find the most useful.

104. We think enhancing the disclosure requirements for E&E expenditure could improve:

(a) the usefulness of information in financial statements—for example, by requiring disclosure of information about E&E expenditure and activities that is more useful to users; and

(b) the comparability of financial statements—for example, by requiring consistent disclosures about E&E expenditure and activities.

105. However, we think this matter would require further research and outreach. For example, to understand:

(a) what information is relevant to an understanding of an entity's E&E expenditure and activities;

(b) whether the lack of information results from inconsistent application of existing requirements or IFRS Standards not requiring entities to provide that information; and

(c) what the cost of providing that information would be.

Staff recommendation

106. Disclosure of information about E&E expenditure and activities is relevant only to entities with extractive activities and is in the scope of IFRS 6.

107. We think developing requirements or guidance for the disclosure of information about E&E expenditure and activities could improve:

(a) the usefulness of information in the financial statements; and

(b) the comparability of financial statements.

108. In particular, we think the suggestions about what information entities should disclose listed in paragraph 103 could provide users with information they need and the Board should explore the feasibility of requiring entities to provide that information. We also note that many users said, in their view, improving disclosures about an entity's E&E

expenditure and activities would be more useful than revisiting the accounting for E&E expenditure.

109. However, the Board would need to further research what information users need, why they do not currently get that information, and the costs and benefits of requiring entities to provide that information.

110. Based on our analysis, we recommend that the Board explore developing requirements or guidance to improve disclosures about E&E expenditure and activities as part of a project on extractive activities.

Question 4 for the Board
Does the Board agree with the staff recommendation in paragraph 110?

Appendix A—Extracts from IFRS 6

…

Measurement of exploration and evaluation assets

…

Elements of cost of exploration and evaluation assets

9 An entity shall determine an accounting policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently. In making this determination, an entity considers the degree to which the expenditure can be associated with finding specific mineral resources. The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

(a) acquisition of rights to explore;

(b) topographical, geological, geochemical and geophysical studies;

(c) exploratory drilling;

(d) trenching;

(e) sampling; and

(f) activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

…

Impairment

Recognition and measurement

18 Exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. When facts and circumstances suggest that the carrying amount exceeds the recoverable amount, an entity shall measure, present and disclose any resulting impairment loss in accordance with IAS 36, except as provided by paragraph 21 below.

19 For the purposes of exploration and evaluation assets only, paragraph 20 of this IFRS shall be applied rather than paragraphs 8–17 of IAS 36 when identifying an exploration and evaluation asset that may be impaired. Paragraph 20 uses the term

'assets' but applies equally to separate exploration and evaluation assets or a cash-generating unit.

20 One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation assets for impairment (the list is not exhaustive):

(a) the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.

(b) substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned.

(c) exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area.

(d) sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

In any such case, or similar cases, the entity shall perform an impairment test in accordance with IAS 36. Any impairment loss is recognised as an expense in accordance with IAS 36.

Specifying the level at which exploration and evaluation assets are assessed for impairment

21 An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment. Each cash-generating unit or group of units to which an exploration and evaluation asset is allocated shall not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*.

22 The level identified by the entity for the purposes of testing exploration and evaluation assets for impairment may comprise one or more cash-generating units.

…

Disclosure

23 An entity shall disclose information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and evaluation of mineral resources.

24 To comply with paragraph 23, an entity shall disclose:

(a) its accounting policies for exploration and evaluation expenditures including the recognition of exploration and evaluation assets.

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

25 An entity shall treat exploration and evaluation assets as a separate class of assets and make the disclosures required by either IAS 16 or IAS 38 consistent with how the assets are classified.

…

Appendix A
Defined terms

…

exploration and evaluation assets	**Exploration and evaluation expenditures** recognised as assets in accordance with the entity's accounting policy.
exploration and evaluation expenditures	Expenditures incurred by an entity in connection with the **exploration for and evaluation of mineral resources** before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.
exploration for and evaluation of mineral resources	The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource.

Appendix B—2010 *Extractive Activities* Discussion Paper[10]

B1. Matters identified in relation to E&E expenditure were analysed, and proposals developed, as part of four topics in the Discussion Paper being:

(a) unit of account (see paragraphs B2–B4);

(b) asset recognition (see paragraphs B5–B6);

(c) asset measurement (see paragraphs B7–B10); and

(d) impairment (see paragraphs B11–B14).

Unit of account

Discussion Paper proposals

B2. Chapter 3 of the Discussion Paper proposed that a unit of account for minerals or oil and gas properties should have 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 (for example, 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.

Summary of feedback

B3. Of those that provided feedback on the unit of account proposal, most generally agreed with the proposal. 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.

B4. A few respondents encouraged the Board to continue to work on unit of account as part of its Conceptual Framework project and they suggested that this work might

[10] See *October 2010 Agenda Paper 7A* and *Agenda Paper 7B*.

inform the identification of the appropriate unit of account for minerals or oil and gas properties.

Asset recognition

Discussion Paper proposals

B5. Chapter 3 of the Discussion Paper 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 E&E activities (for example, information that will assist the entity in making assessments about 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.

Summary of feedback

B6. Of those respondents that provided feedback on this proposal:

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

(b) most disagreed with the proposal that information obtained from subsequent E&E activities would always enhance the property at the time that information is obtained. These respondents said the project team's treatment of the cost of those E&E activities as assets was inconsistent with the asset recognition criteria in the 2010 *Conceptual Framework for Financial Reporting*. This is because information obtained from subsequent E&E activities may not have any probable future economic benefit.

Asset measurement

Discussion Paper proposals

B7. Chapter 4 of the Discussion Paper proposed that, on cost-benefit grounds, an entity's minerals and oil and gas properties should be measured at historical cost. To compensate for the apparent lack of useful information provided by this measurement,

the project team also proposed that an entity should provide detailed disclosures about those assets to enhance the relevance of the financial statements.

Summary of feedback

B8. Almost all respondents agreed with the proposal to measure an entity's minerals or oil and gas properties at historical cost because such a measure:

(a) would be verifiable;

(b) could be prepared in a timely manner; and

(c) could be used to assess financial performance and stewardship.

B9. These respondents explained they did not support a fair value approach because it would introduce excessive subjectivity and short-term volatility. It would also impose significant preparation and audit costs which are not justified because users are not interested in that information.

B10. A few respondents supported measuring minerals and oil and gas properties at fair value (or any other current value). These respondents said:

(a) industry-specific and other valuation guidance could be used to promote consistent preparation of those valuations; and

(b) in their view, insufficient research was undertaken on asset measurement alternatives and that the user survey in the Discussion Paper was biased towards sophisticated users that have the necessary time, expertise and information to make their own estimates of value. Measuring those assets at fair value would benefit other users.

Impairment

Discussion Paper proposals

B11. The Discussion Paper proposed that IAS 36 not apply to properties in the E&E phase. The project team concluded it would not be possible to make reliable judgements that the carrying amount of any exploration property would be less than its recoverable amount until sufficient information is available to evaluate the exploration results and determine whether economically recoverable quantities of minerals or oil and gas have been found. Consequently, the Discussion Paper proposed an alternative impairment approach in which an entity would:

(a) write down the exploration property only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full; and

(b) apply a separate set of indicators to assess whether the entity's exploration properties can continue to be recognised as assets.

Summary of feedback

B12. Most respondents that provided feedback on this proposal opposed the proposal for the following reasons:

(a) it would create an exception to IAS 36 (although a similar exemption already existed in IFRS 6);

(b) it could overstate the exploration property in the statement of financial position and delay the recognition of an impairment loss; and

(c) there would be too much reliance on management judgement to identify when the carrying amount of the asset will not be recoverable in full which could adversely affect comparability of financial statements.

B13. Some respondents acknowledged the difficulty in applying IAS 36 to exploration properties because the specified indicators of impairment cannot be easily applied to them and there is often limited information available to reliably estimate their recoverable amount. Some of these respondents suggested reviewing IAS 36 so that the Standard can be applied to those assets. A few suggested adopting a derecognition approach rather than an impairment approach for exploration assets.

B14. Some respondents said the fact that IAS 36 is not considered to work for exploration assets may imply that the proposed asset recognition approach was inappropriate.

Appendix C—Summary of outreach and research activities

C1. Appendix C summarises the following outreach and research activities relevant to matters in the scope of IFRS 6:

(a) developments regarding proposals in the Discussion Paper (paragraphs C2–C8);
(b) outreach with stakeholders (paragraphs C9–C15);
(c) research findings on applying IAS 16 or IAS 38 in the absence of IFRS 6 (paragraphs C16–C17);
(d) research findings from academic literature review (paragraphs C18–C23); and
(e) research findings on the diversity of accounting policies applied (paragraphs C24–C27).

Developments regarding proposals in the Discussion Paper[11]

C2. In 2018, the Extractive Activities research project was activated. As part of this reactivation, we requested feedback from the national standard-setters who helped develop the Discussion Paper (being Australia, Canada, Norway and South Africa) to inform the Board of any significant developments since the publication of the Discussion Paper in 2010 (see ***Agenda Paper 19*** of this meeting).

C3. The national standard-setters noted that not all analysis and proposals of, and feedback to, the Discussion Paper may still be relevant.

Unit of account and asset recognition

C4. In March 2018 the Board issued the revised *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*). The changes included a revised asset definition, revised concepts for the recognition of assets and additional concepts for selecting a unit of account.

C5. The Discussion Paper proposed treating E&E expenditure as assets (Appendix B). Based on our analysis, we concluded that:

(a) E&E expenditure incurred to acquire legal rights to undertake E&E activities can meet the revised recognition criteria of an asset in the 2018 *Conceptual Framework*.
(b) E&E expenditure incurred subsequent to the acquisition of legal rights to undertake E&E activities could give rise to an asset (or assets) applying the 2018 *Conceptual Framework*. However, recognising such expenditure as assets is appropriate only if such recognition provides users with useful information (that is, relevant information that provides a faithful representation of what it purports to represent).

[11] See ***September 2019 Agenda Paper 19C*** and ***Agenda Paper 19D***.

(c) the unit of account proposed in the Discussion Paper[12] remains appropriate applying the 2018 *Conceptual Framework*, but that other units of account could also be appropriate applying the 2018 *Conceptual Framework* and could provide useful information. Therefore, the selection of an appropriate unit of account could be explored further.

Asset measurement and impairment

C6. Since issuing the Discussion Paper in 2010, the Board issued:

(a) IFRS 13 *Fair Value Measurement* (June 2011);

(b) amendments to IAS 36 (May 2013);

(c) amendments to IAS 16 and IAS 38 (May 2014); and

(d) the 2018 *Conceptual Framework* (March 2018).

C7. The Discussion Paper analysed the historical cost and fair value measurement bases and proposed applying a historical cost measurement base (Appendix B). We noted that:

(a) applying the 2018 *Conceptual Framework* a different measurement basis, or combination of measurement bases, might be more appropriate than historical cost. Alternatively, the 2018 *Conceptual Framework* could provide further support for historical cost as the measurement basis.

(b) using revenue as a basis for depreciation or amortisation may no longer be appropriate when applying paragraphs 62A of IAS 16 or 98A of IAS 38.

Conclusion

C8. We concluded that the analysis and proposals in the Discussion Paper, including feedback to the Discussion Paper, remain relevant and should be considered when determining the scope and objectives of any project on extractive activities.

Outreach[13]

Applying IFRS 6

C9. Many stakeholders said users do not request additional information about the accounting of E&E expenditure. Instead, they said users generally request other information, such as cash flow information, non-GAAP performance measures and reserve and resource information.

[12] See paragraph B2 of Appendix B.

[13] See ***March 2019 Agenda Paper 19*** and ***June 2020 Agenda Paper 19A***.

C10. Some stakeholders also said it is important to have the ability to develop the most appropriate accounting policy for E&E expenditure. This is because of the diversity of entities operating in the extractive industries—for example:

(a) some said this allows entities that are listed in multiple jurisdictions to comply with both IFRS Standards and jurisdictional regulatory requirements in other jurisdictions (such as US GAAP). In their view this reduces the diversity in accounting policies developed in that industry.

(b) a few said capitalising E&E expenditure is important for smaller entities, such as junior exploration entities, and directly affects their ability to attract future investment.

(c) a few said larger entities, such as those with mining operations, recognise E&E expenditure as expenses in the income statement because the expenditure is generally not material.

C11. However, some stakeholders said IFRS 6 contributes to the diversity in accounting for E&E expenditures and could be improved. These stakeholders suggested developing requirements relating to:

(a) unit of account—a few stakeholders suggested developing guidance about the unit of account to be applied when accounting for E&E expenditure. These stakeholders suggested clarifying whether the unit of account should be:

(i) the geographical area(s) in which an entity operates;

(ii) the project in which an entity is engaged (which could span multiple geographical areas);

(iii) a single well or deposit; or

(iv) a group of wells or deposits clustered in a single geographical area.

(b) definition of E&E expenditure—a few stakeholders suggested clarifying which costs should be classified as E&E expenditure because there is diversity in this regard.

(c) acquisition of exploration rights—a few stakeholders said exploration rights often have terms and conditions attached to them for which, in their view, the accounting treatment is not always clear.

(d) accounting policy choices—a few stakeholders suggested amending IFRS 6 to remove the existing accounting policy choice for E&E expenditures.

(e) transition from the E&E phase(s)—a few stakeholders suggested clarifying the point at which an entity completes the E&E phase(s) and moves into the development phase (and hence moves out of the scope of IFRS 6).

C12. Less than a few stakeholders said although paragraphs 15–16 of IFRS 6 include requirements to help entities classify E&E assets as tangible or intangible, there

remains uncertainty about the classification of E&E assets. These stakeholders suggested clarifying further what is meant by 'intangible' in the context of IFRS 6.

Interaction of IFRS 6 with other IFRS Standards

C13. Some stakeholders (in particular, preparers and national standard-setters) said notwithstanding the exceptions IFRS 6 provides from specific requirements in IAS 36, IAS 36 can be difficult to apply to E&E assets. In particular, these stakeholders said challenges arise because:

(a) it is difficult to determine the recoverable amount of E&E assets—a few stakeholders suggested developing guidance about how to determine the recoverable amount of E&E assets.

(b) it is difficult to determine how long E&E assets should remain on the balance sheet—for example, when an entity decides to defer the development of a mineral or oil or gas project for several years in favour of other projects.

(c) of diversity regarding the unit of account applied to E&E assets.

C14. A few preparers also:

(a) expressed uncertainty about the interaction between IFRS 6 and IFRS 16 *Leases* which is commonly applied in the extractive industries.

(b) said IFRS Standards do not specifically address the capitalisation of borrowing costs incurred in relation to E&E activities.

C15. A few stakeholders said, in their view, E&E expenditure that is intangible in nature is similar to R&D expenditure that is accounted for applying IAS 38 and should not be accounted for differently. However, a few others said E&E expenditure differs from R&D expenditure because, for example:

(a) there is no correlation between the cost of capitalised E&E expenditure and the value of any mineral or oil and gas deposit—a pharmaceuticals entity can recover the cost of their research and development phases because they are able to set their own price whereas this is not generally the case for entities with extractive activities; and

(b) when successful, E&E expenditure results in a physical item, the mineral deposit, whereas R&D expenditure ultimately results in an intangible item, knowledge.

Research findings on applying IAS 16 or IAS 38 in the absence of IFRS 6[14]

C16. We analysed the potential accounting treatment for E&E expenditure assuming IFRS 6 did not exist and an entity would instead apply IAS 16 and IAS 38 to E&E

[14] See *July 2020 Agenda Paper 19A*.

expenditure. The analysis did not consider extractive activities outside the scope of IFRS 6 such as development and production activities.

C17. We concluded that, in this situation, it is likely that an entity would recognise the majority of E&E expenditure as an expense in the period it incurred that expenditure.

Research findings from academic literature review[15]

C18. We analysed academic evidence on extractive activities. Our analysis focused on academic papers published around or after the Discussion Paper was issued. The analysis was based mainly on evidence from IFRS jurisdictions but included US-based evidence when such evidence was considered useful and comparative IFRS-based evidence was unavailable.

C19. The number of international comparative studies on accounting for extractive activities is very limited. This is possibly due to diversity in accounting for extractive activities both within and between countries which makes comparisons difficult.

C20. Academic literature showed that entities with extractive activities applied a wide range of accounting policies to E&E expenditures. Accounting policies varied by country, by sub-industry sector (oil and gas, and mining) and by entity size. In some researchers' views, extractive industries influenced the IFRS 6 standard-setting process and contributed to codifying then existing unregulated industry practices.

C21. One study showed E&E expenditure was not value relevant (positively associated with share prices) when entities chose methods deviating from those commonly used by entities of the same size and in the same industry. In the authors' view, the ability to choose the most appropriate accounting policy for E&E expenditure allowed entities to provide useful information.

C22. Capitalised E&E expenditure of oil and gas entities was value relevant but there was mixed evidence on the value relevance of mining entities' capitalised E&E expenditure. One academic study showed the value relevance of both immediately expensed and capitalised E&E expenditure of mining entities, suggesting it did not matter whether minerals entities expensed or capitalised E&E expenditures.

C23. One study found that analysts developed more private information and produced more accurate forecasts for extractive entities with a higher amount of E&E expenditure. In the authors' view, analysts contributed to reducing information asymmetry between entities with extractive activities and users.

[15] See ***July 2020 Agenda Paper 19B***.

Research findings on the diversity of accounting policies applied[16]

C24. We analysed:

(a) whether jurisdictional accounting requirements exist that differ from the requirements in IFRS 6; and

(b) the diversity in accounting policies developed applying IFRS 6.

C25. Accounting policies developed applying IFRS 6[17] are diverse. Furthermore, research indicated that this diversity is primarily due to:

(a) the extent to which an entity decides to recognise E&E expenditure incurred during the reporting period as an asset—that is, the judgements an entity applies in determining which of its E&E expenditure to capitalise, and from what point to commence capitalisation; and

(b) the judgement an entity applies to determine to unit of account to apply to its E&E asset (or assets).

C26. There are some geographical trends in the accounting policies developed for E&E expenditure. These arise because some jurisdictions require entities to apply a specific accounting policy. For example:

(a) oil and gas entities reporting in the US applying US GAAP are required to apply either the successful efforts or full cost method to E&E expenditure;

(b) oil and gas entities reporting in China are required to apply the accounting requirements described in Accounting for Business Enterprises No. 27 Extraction of Oil and Natural Gas; and

(c) entities applying the Australian Accounting Standard AASB 6 are required to use an 'individual geological area of interest' as the unit of account when accounting for E&E expenditure.

C27. We also noted some industry trends. For example, entities in the oil and gas industry generally apply successful efforts and full cost accounting policy methods. Additionally, although entities in both extractive industries are more likely to capitalise E&E expenditure, based on the sample, entities in the minerals industry were more likely to either expense all E&E expenditure, or capitalise only the acquisition of legal rights, than oil and gas entities.

[16] See ***October 2020 Agenda Paper 19A***.

[17] Our analysis also considered accounting requirements that are equivalent to IFRS 6 such as AASB 6.

Appendix D—Summary of targeted investor outreach

D1. More recently, we conducted a survey and held one-to-one meetings with a range of investors to better understand their views on the diversity of accounting policies developed applying IFRS 6 and the importance of reserve and resource information (see also Appendix C of ***Agenda Paper 19E*** of this meeting). It is important to note that those investors that provided additional feedback on their survey answers focused predominantly on larger entities (that is, entities engaged in all extractive activities) rather than smaller entities that only engaged in E&E activities.

D2. As part of that survey, we asked:

(a) how important information about an entity's E&E expenditure is;

(b) how problematic any diversity in accounting for E&E expenditure is; and

(c) how to tackle any diversity in accounting for E&E expenditure.

D3. Many investors said information about E&E expenditure is very important. They use that information as an input to their analysis. In particular, those investors that provided additional feedback said information about an entity's E&E expenditure:

(a) is important for smaller entities undertaking mainly E&E activities. For these entities, E&E expenditure is likely to be material to the financial statements and E&E activities are often critical to their future.

(b) is important to help users:

(i) compare entities in the same industry. For example, one investor said they had limited interest in the amount of E&E expenditure itself, however, they needed the information in order to adjust metrics and facilitate comparisons between entities applying US GAAP and those applying IFRS Standards.

(ii) identify trends over time—for example, whether an entity's investment in E&E activities is sufficient to maintain their project pipeline and market position.

(iii) assess management's decisions and ability to allocate capital to exploration activities.

(iv) to facilitate a conversation with management—for example, one investor said qualitative information about the E&E expenditure and the type of project it relates to was important, and the information in the financial statements helps them to have discussions with management about this.

(v) calculate specific metrics—for example, one investor said information about E&E expenditure helps estimate future depreciation and amortisation and any likely effect on earnings.

D4. Despite many investors saying information about E&E expenditure is very important, most said the differences in accounting for E&E expenditures was only somewhat of a problem requiring them to have to adjust their analyses. Investors that provided additional feedback went on to explain that this was because:

(a) as one investor explained, they looked at free cash flows and whether E&E expenditure was expensed or capitalised did not matter;

(b) although earnings was an important metric for one investor, and different accounting policies could affect that metric, the accounting policy differences had not had a significant effect on that investor's recommendations due to the type of well diversified entities they followed; and

(c) metrics that can be affected by accounting policy differences are cross checked to cash flow metrics that are not affected.

D5 Although many investors suggested that the Board require all entities to apply the same accounting policy, many others suggested that the Board instead improve disclosures about E&E expenditure.