

14 April 2004



Mr Colin Fleming
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By email: CommentLetters@iasb.org

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Dear Mr Fleming

Comments on ED6: Exploration for and Evaluation of Mineral Resources

CPA Australia is pleased to provide comments on Exposure Draft ED 6: *Exploration for and Evaluation of Mineral Resources*. This submission has been prepared by the Financial Reporting and Governance Centre of Excellence of CPA Australia and represents the considered views of CPA Australia.

We offer the following general comments as well as answers to the specific questions raised in ED 6.

General comments

Objective of ED 6

We strongly support the objective in ED 6.1(a) "to make limited improvements to accounting practices for exploration and evaluation of mineral resources without requiring major changes that may need to be reversed when the Board undertakes a comprehensive review of accounting practices".

We urge the Board to place a high priority on developing the comprehensive project on accounting and financial reporting issues for the extractive industries. Entities within the industry have developed practices that some argue are not consistent with the IASB *Framework* and we are of the view that leaving entities to apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* without guidance, and in the context of the scope exclusions in other IFRSs, is unlikely to lead to comparable reporting.

Impact of ED 6

We are concerned that the proposals in ED 6 do not achieve the stated objective. We consider that it is likely that a standard incorporating the proposals in ED 6 without change will require major changes to the accounting practices of many entities. We note that paragraphs BC36-BC38 accept that issuance of a standard from ED 6 after 31 March 2004 that is to apply from 1 January 2005 is acceptable because the standard will not require major changes to existing practices. We urge the Board to ensure that major changes are not required by the standard arising from ED 6.

Entities involved in exploration and evaluation in Australia range from large multi-national companies involved in all aspects of the industry, through to small entities that limit their activities to exploration. The majority of larger entities expense exploration and evaluation expenditure (regardless of whether or not the expenditure qualifies as an asset). Even without ED 6, we suspect that such entities would continue not to capitalise exploration and evaluation expenditure and are therefore less likely to be affected by ED 6.

Generally, the majority of smaller entities recognise exploration and evaluation assets. We are concerned that the application of ED 6 would potentially prevent smaller entities from capitalising exploration and evaluation expenditure because they would be unable to satisfy impairment trigger in paragraph 13(f) and positively state that the entity considers that the recognised exploration and evaluation assets are reasonably capable of being recoverable.

Further, we note that commentators on ED 6 appear to have different interpretations of the proposals. Some consider that the ultimate effect of the proposals is that all entities will have to expense all exploration and evaluation expenditure because the recoverability of exploration and evaluation expenditure is uncertain. Others interpret the proposals to permit the recognition of exploration and evaluation assets unless the entity considers that recoverability is not probable. We urge the Board to eliminate this confusion by clarifying the intended interpretation.

We recommend that, in order to meet the Board's intention to permit the continuance of many existing practices, the standard arising from ED 6 permit the continued recognition of exploration and evaluation assets until it is known that the exploration and evaluation asset is impaired. As drafted, we are concerned that many entities will be required to write-off exploration and evaluation assets unless future cash flows from the exploration are at least probable.

Application of IFRS 1

There is confusion as to whether IFRS 1 *First-time Adoption of IFRSs* requires entities to test assets for impairment or to assess whether any impairment triggers exist at transition date. If it is the Board's intention to require all assets to be tested for impairment at transition date, then it is likely that many pre-transition exploration and evaluation assets will have to be impaired.

We recommend that the Board consider the impact of IFRS 1 on exploration and evaluation assets, and ensure that the requirements at transition do not negate the Board's decision for ongoing recognition.

Timing of finalisation of standard

We are concerned that the standard to be developed from ED 6 is planned to be issued in the final quarter of 2004. Given the uncertainty as to the appropriate interpretation of the ED, as noted above, we urge the Board to make every endeavour to issue the standard before that date to eliminate the uncertainty as to the intention of ED 6.

Specific issues raised by the IASB

1. Definition and additional guidance

We support the definitions and additional guidance related to exploration and evaluation assets, exploration and evaluation expenditure and exploration for and evaluation of mineral resources.

As discussed below, we do not support the existence of a definition of cash-generating unit for exploration and evaluation assets (CGU-EEA). If this definition is to be retained, we see no reason why use of the CGU-EEA is restricted to those entities that applied impairment tests under their former accounting policies. Given that entities will be required to consider impairment issues under IFRS 1, it appears unnecessary to consider whether or not those entities considered impairment prior to the application of IFRS 1 or ED 6.

2. Method of accounting for exploration for and evaluation of mineral resources

We strongly support the proposal to permit entities to continue to apply their previous accounting policies in accounting for exploration and evaluation expenditures. As noted above, under our general comments, we are concerned that the proposals in ED 6 do not achieve this:

- there is confusion as to whether the application of IFRS 1 will require entities to test such assets for impairment on transition to IFRSs (as distinct from considering whether or not there are any indicators of impairment)
- many entities that recognise exploration and evaluation assets do so on the basis that they are uncertain about the recoverability of the expenditure. This approach would still be permitted under the impairment indicators proposed in paragraph 13(a) to (e). However, the impairment indicator in paragraph 13(f) is interpreted by many to prohibit the recognition of exploration and evaluation assets except where the capitalised amount is known to be recoverable.

3. *Cash-generating unit for exploration and evaluation assets (CGU-EEA)*

We see no benefit in practice in developing a definition of CGU-EEA and recommend that it be eliminated.

As drafted, the definition permits those explorer-producers that recognise exploration and evaluation assets to continue to recognise such assets where the outcome is unknown by including them with a broad range of production assets within a business segment. For example, an entity conducting exploration for a specific mineral on a continent where it has no productive activities would be permitted to include cash flows from production activities on other continents in assessing impairment using the CGU-EEA. If the aim of ED 6 is to prevent the continued recognition of stand-alone exploration and evaluation assets without knowledge of the recoverability of future cash flows, this aim is unlikely to be achieved in the case of explorer-producers.

In the case of exploration-only entities, the majority in Australia conduct speculative exploration activities, planning to sell any results to a production company. For these entities, there are no production or other cash flows from continuing use regardless of the definition of the cash-generating unit. As a result, for these entities, the most likely cash-generating unit would be the entire entity. Applying the definition of a cash-generating unit in IAS 36 *Impairment of Assets* would have the same impact.

If the definition of CGU-EEA is to be retained, we see no reason to require entities to have performed impairment testing under their previous accounting policies. We do not understand the relationship between permitting exploration and evaluation assets to be tested for impairment at a higher level for future impairment testing and past practices in relation to impairment testing.

4. *Identifying exploration and evaluation assets that may be impaired*

We support the impairment indicators in paragraphs 13(a) to (e).

We do not support the indicator in paragraph 13(f). As drafted, it states “the entity does not expect the recognised exploration and evaluation assets to be reasonably capable of being recoverable from a successful development of the specific area, or by its sale”. Many are interpreting this indicator to require an impairment test to ensure recoverability. That is, this indicator is being interpreted as requiring impairment testing rather than considering whether there are any indicators of impairment.

We recommend that this be redrafted in the form of an **indicator** of impairment rather than as a **test** of impairment, in a form such as “the entity ~~does~~ has no reason not to expect the recognised exploration and evaluation assets to be reasonably capable of being recoverable from a successful development of the specific area, or by its sale”.

5. *Disclosure*

We support the proposed disclosures.

If you have any questions regarding the above, please contact Patricia McBride (email: patricia.mcbride@cpaaustralia.com.au; telephone: +61 3 9606 9770).

Yours sincerely

A handwritten signature in black ink, appearing to read "G. Larsen".

Greg Larsen, FCPA
Chief Executive
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