acteo Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

CL 12

Sir David TWEEDIE
Chairman IASB

IASB
30 Cannon Street
LONDON EC4M 6XH
UK

JK/SJ/04.2004/20
RE : Exposure draft on ED6

Paris, Friday 9th April 2004

Dear Sir,

We would like to thank you to give us the opportunity to comment the exposure draft of the interpretation on ED6.

Please find enclosed the answer on this subject that ACTEO and MEDEF have prepared jointly.

Should you wish further comments or developments, please let us know and we would promptly answer to your requests.

Yours sincerely,

ACTEO

Philippe CROUZET
Le Président

P/O ***Jean KELLER***

Le Délégué Permanent

MEDEF

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Exposure-draft ED 6 : Exploration and evaluation of mineral resources

Overview of Acteo's position

Acteo welcomes the issuance of an interim standard dealing with exploration and evaluation of mineral resources assets (E&E assets) to be applied as part of IFRS literature until such time when the IASB can devote appropriate staff resources and Board time to address a full project on these issues. To allow for present accounting principles to prevail in the meanwhile stands, in our view, as a wise solution.

We understand and support the need to apply IAS 36 to E&E assets and also support the Board's efforts to adjust IAS 36 requirements to E&E assets peculiarities. However we do not believe that the choice made by the Board in that area is the right one. We develop in our recommendations to the Board an alternative that, in our view, should permit to avoid any disruption in the accounting practices of the entities, while providing the same level of safeguard that the Board seems to have intended to.

Question 1 : **Definition and additional guidance**

The proposed IFRS includes definitions of exploration for and evaluation of mineral resources, exploration and evaluation expenditures, exploration and evaluation assets and a cash-generating unit for exploration and evaluation assets. The draft IFRS identifies expenditures that are excluded from the proposed definition of exploration and evaluation assets. Additional guidance is proposed in paragraph 7 to assist in identifying exploration and evaluation expenditures that are included in the definition of an exploration and evaluation asset (proposed paragraphs 7 and 8, Appendix A and paragraphs BC12- BC14 of the Basis for conclusions).

Acteo's answer

We agree with the definitions set forth for exploration and evaluation expenditures and assets. We however disagree with the definition given to the "cash-generating unit for exploration and evaluation assets". Our disagreement is based on the following reasons:

- the definition includes a reference to the previous impairment practices of the entity. We believe that the requirements included in the future IFRS as well as in any IFRS must be the same for all entities;
- previous impairment practices may rely on a logic or practice quite different from IAS 36 approach and the level at which impairment was assessed may not match the IAS 36 impairment test requirement.

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We therefore suggest that the definition for a "cash-generating unit for exploration and evaluation assets" reads as follows: "the identifiable group of assets that, together with explorations and evaluation assets, generates cash inflows from continuing use. A cash-generating unit for exploration and evaluation assets shall be no larger than a segment".

Question 2 : **Method of accounting for exploration for and evaluation of mineral resources**

a) Paragraphs 10-12 of IAS 8 Accounting *Policies*, *Changes in Accounting Estimates and Errors* specify sources of authoritative requirements and guidance an entity should consider in developing an accounting policy for an item if no IFRS applies specifically to that item. The proposals in the draft IFRS would exempt an entity from considering the sources in paragraphs 11 and 12 when assessing its existing accounting policies for exploration and evaluation expenditures by permitting an alternative treatment for the recognition and measurement of exploration and evaluation assets. In particular, the draft IFRS would permit an entity to continue to account for exploration and evaluation assets in accordance with the accounting policies applied in its most recent annual financial statements.
b) The Exposure Draft proposes that an entity would continue to use its existing accounting policies in subsequent periods unless and until the entity changes its accounting policies in accordance with IAS 8 or the IASB issues new or revised Standards that encompass such activities (proposed paragraph 4 and paragraphs BC8 – BC11 of the Basis for Conclusions).

Are these proposals appropriate? If not, why not?

Acteo's answer

We agree with the Board's proposals.

Question 3 : **Cash-generating units for exploration and evaluation assets**

IAS 36 requires entities to test non-current assets for impairment. The draft IFRS would permit an entity that has recognised exploration and evaluation assets to test them for impairment on the basis of a "cash-generating unit for exploration and evaluation assets" rather than the cash-generating unit that might otherwise be required by IAS 36. This cash-generating unit for exploration and evaluation assets is used only to test for impairment exploration and evaluation assets recognised under proposed paragraph 4 (see proposed paragraphs 12 and 14 and paragraphs BC15 – BC23 of the Basis for Conclusions).
Are the proposals appropriate? If not, why not? If you disagree with the proposal that exploration and evaluation assets should be subject to an impairment test under IAS 36, what criteria should be used to assess the recoverability of the carrying amount of exploration and evaluation assets?

Acteo's answer

We understand and support the effort made by the Board in order to allow for present accounting policies that might be of a great diversity, while ensuring that overall the assets involved in an extractive industry are not reported at a higher value than their overall recoverable value.
We however do not support the solution identified by the Board.

Exploration and evaluation assets are of a very different nature than regular non-current assets that generally are either purchased or produced in order to be operated in the state they are when they are first recognised in the financial statements. IAS 36 is well designed for these assets, where a change in the facts and circumstances surrounding the operation of the asset is a strong indicator that something has happened that needs to be addressed.

Exploration and evaluation assets reach the same stage only when the development of the resources identified starts. Beforehand they are an asset under "construction" of which construction may or may not be pursued by management. They are therefore under constant scrutiny since management has recurring decisions to make as to whether they are pursued or not.

This scrutiny is operated at each field level and not on an overall basis. Right from the start the field level (level at which the rights to explore are acquired) is standing as a "cash-generating unit" in a manner consistent with IAS 36 definition. However decisions are not made on the basis of computed cash-flows! Decisions are documented on the basis of measurements and assessments made by geological experts that allow, or disallow, for enough hopes of successful discoveries to sustain further exploration and evaluation assets. Most of the indicators set out in paragraph 13 of the Exposure Draft (a, b, c, d, f) reflect indeed management's decisions not to pursue the exploration or the development of mineral resources fields.

According to present accounting principles and practices of numerous companies operating in extractive industries, decisions made by management not to pursue the exploration, and intermediate analyses that point to less resources than was previously assessed, call for the immediate partial or total write-off of the exploration and evaluation assets that may have been capitalised since the beginning of the exploration. Such a practice is, in our view, sound, although not based on precise cash-flow forecasts. The future standard must not prescribe requirements that, de facto, would require such sound practices to be abandoned.

We therefore disagree with the Board requirement (paragraph 14) that an entity should make the choice between testing exploration and evaluation assets for impairment on the basis of either a "cash-generating unit" or a "cash-generating unit for exploration and evaluation assets", one solution excluding the other in the application of IAS 36.
Entities would indeed be squeezed into a bad choice between:

- either selecting the "cash-generating unit" and hence having to either impair valuable exploration and evaluation assets and/or enter into very artificial documentations of future cash-flows,
- or select the "cash-generating unit for exploration and evaluation assets" and be deprived from the ability to amortise exploration and evaluation assets that would not be carried into the stage of development, because the large cash-generating unit would work as a "cushion".

We believe that, in full consistency with paragraph 4 and with the same objective as to the impairment test, the future IFRS should require that:

- exploration and evaluation assets be amortised on the bases on, and at the level at, which they were previously amortised,
- a safeguard test, consistent with IAS 36 requirements, be carried out at the level of a "cash-generating unit for exploration and evaluation assets" defined as suggested in our answer to question 1.

We also call for a re-drafting of paragraph 12 in order to make it fully consistent with draft IAS 36 paragraph 8.
Instead of requiring that "an entity…shall assess E&E assets for impairment annually", it should state that "an entity "shall assess at each balance sheet date whether there is an indication that E&E assets might be impaired" (or alternatively state that IAS 36 paragraph 8 applies). Written as proposed, paragraph 12 could be thought to require a systematic computation of the recoverable amount of E&E assets, which we understand was not the Board's intent.

Question 4 : **Identifying exploration and evaluation assets that may be impaired**

The draft IFRS identifies indicators of impairment for exploration and evaluation assets. These indicators would be among the external and internal sources of information in paragraphs 9 – 13 of IAS 36 that an entity would consider when identifying whether such assets might be impaired (paragraph 13 and paragraphs BC 24 – BC 26 of the Basis for Conclusions).

Acteo's answer

We agree with the indicators listed in paragraph 13 which as explained in our answer to question 3 are a fair reflection of the decisions that management makes when exploration and evaluation are not successful.

Question 5 : **Disclosures**

To enhance comparability, the draft IFRS proposes to require entities to disclose information that identifies and explains the amounts in its financial statements that arise from the exploration for and evaluation of mineral resources (proposed paragraphs 15 and 16 and paragraphs BC32 – BC 34 of the Basis for Conclusions).
Are the proposed disclosures appropriate? If not, why not? Should additional disclosures be required? If so, what are they and why should they be required?

Acteo's answer

We agree with the required disclosures included in paragraph 15 and 16.