BG Group

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Colin Fleming
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Dear Mr Fleming

Exposure Draft 6 – Exploration for and Evaluation of Mineral Resources

We are responding to the invitation to comment on exposure draft 6 on exploration for and evaluation of mineral resources. Our main concern with this draft is that its approach to impairment testing does not appear to be consistent with successful efforts accounting. This method of accounting for exploration and development activities is set out in the UK SORP on accounting for oil and gas activities, has been adopted by a number of oil and gas companies, and is well understood by the investor community.

In addition, we would like to make the following points on the proposals for impairment testing set out in the draft:

- We agree that exploration and evaluation assets should be assessed for recoverability on a periodic basis. However the nature of the activity means that a quantitative test based on discounted cash inflows as proposed in the draft IFRS is not appropriate. Until the success or failure of each effort is established, exploration assets should be measured at cost on the basis that management believe there is a reasonable prospect of commercial reserves being discovered and developed. Many companies involved in oil and gas exploration use successful efforts accounting whereby exploration expenditure which is either general in nature or relates to unsuccessful drilling operations is written off to income. Each asset pending determination should be reviewed and impaired only to the extent there is a change in circumstances suggesting the effort will not result in the development of commercial reserves. This is the approach adopted by the UK SORP; in addition the SORP restricts the amount of time exploration and appraisal assets can be carried forward.

- If a detailed impairment test is required for exploration assets, companies should be allowed to take into account future development costs to be incurred to exploit estimated future reserves and the future cash flow benefits from these reserves when determining the value in use of these assets. This will require a number of assumptions to be made, in particular over the level of commercial reserves at each asset, which will be imprecise and subject to material change when additional information becomes available.

- The proposed definition of a “cash-generating unit for exploration and evaluation assets” is confusing and in some circumstances would be difficult to apply. Not all exploration and evaluation assets fit comfortably within a group of cash-generating assets either geographically or operationally. The proposals could result in circumstances where exploration and evaluation assets are tested for impairment using the cash inflows from a group of unrelated assets.

Our responses to the specific questions set out in the invitation to comment are attached.

Yours sincerely

Alistair Williams

Group Financial Controller

Q1 – 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 paragrpahs 7 and 8, Appendix A and paragrpahs BC12-BC14 of the Basis for Conclusions).

BG's response
The definitions of exploration and evaluation assets and expenditures are considered appropriate. The guidance proposed in paragraph 7 of the draft IFRS concerning which expenditures may be capitalised as part of an exploration and evaluation asset is reasonable; however clarification would be enhanced by a statement that the list is not exhaustive. The IFRS should also distinguish between directly attributable and general overheads. Directly attributable overheads incurred in relation to exploration and evaluation activities meet the criteria for capitalisation and this should be made clear in paragraph 7 of the final IFRS. It is correct that administration and general overhead costs should not be included in the measurement of exploration and evaluation assets as stated in paragraph 8.

Q2 – Method of accounting for exploration 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 account for exploration and evaluation assets in accordance with the accounting policies applied in its most recent 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.

Are these proposals appropriate? If not, why not?

BG's response
BG considers the proposals appropriate as an interim measure.

Q3 – 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 is used only to test for impairment exploration and evaluation assets recognised under proposed paragraph 4.

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?

BG's response
We agree that exploration and evaluation assets should be assessed for recoverability, however the nature of the activity means that a quantitative test based on discounted cash inflows as proposed in the draft IFRS is not appropriate.

The proposed definition of a “cash-generating unit for exploration and evaluation assets” is confusing and in some circumstances would be difficult to apply. Not all exploration and evaluation assets fit comfortably within a group of cash-generating assets either geographically or operationally. The proposals could result in circumstances where exploration and evaluation assets are tested for impairment using the cash inflows from a group of unrelated assets. The identification of the most relevant cash-generating unit for exploration and evaluation assets is subjective, different groupings with different cash inflows would result in different measures of impairment loss. Any loss recognised under these proposals would not be an accurate measure of the impairment of a specific exploration and appraisal asset but of the profitability of existing cash-generating assets. In particular it would appear to test whether a specific group of producing assets is expected to generate enough cash to finance part of the entity’s existing exploration and evaluation activities in addition to its current development programmes. This is not considered to be an appropriate indicator of impairment of exploration and evaluation assets but an additional impairment test of cash-generating units.

Until the success or failure of each effort is established, exploration assets should be measured at cost on the basis that management believe there is a reasonable prospect of commercial reserves being discovered and developed. Many companies involved in oil and gas exploration use successful efforts accounting whereby exploration expenditure which is either general in nature or relates to unsuccessful drilling operations is written off to income. Each asset pending determination should be reviewed and impaired only to the extent there is a change in circumstances suggesting the effort will not result in the development of commercial reserves. These assets are not subject to the detailed rules for assessing impairment set out, under UK GAAP, in FRS 11. This is the approach adopted by the UK SORP on accounting for oil and gas activities; in addition the SORP restricts the amount of time exploration and appraisal assets can be carried forward.

The recoverability of exploration and appraisal assets is impractical to quantify using techniques applicable to cash-generating units. The capitalised expenditures represent management’s expectations that there is a reasonable probability that commercial reserves will be discovered. The testing of impairment and subsequent recognition of any loss should be restricted to instances when there are clear external or internal indicators that circumstances relating to the specific exploration and evaluation asset have changed. This is considered preferable to an additional impairment test based on the cash inflows of potentially unrelated assets. We believe this is consistent with the definition and recognition criterion for assets included in the IASB framework.

However, if a detailed impairment test is required for exploration assets, companies should be allowed to take into account future development costs to be incurred to exploit estimated future reserves and the future cash flow benefits from these reserves when determining the value in use of these assets. This will require a number of assumptions to be made, in particular over the level of commercial reserves at each asset, which will be imprecise and subject to material change when additional information becomes available.

Q4 – Identifying exploration and evaluation assets that may be impaired

The draft IRS 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.

Are these indicators of impairment for exploration and evaluation assets appropriate? If not, why not? If you are of the view that additional or different indicators should be used in assessing whether assets might be impaired, what indicators should be used and why?

BG’s response
The indicators of impairment for exploration and evaluation assets are appropriate.

Q5 – Disclosure

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.

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?

BG's response
The proposed disclosures are appropriate.