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THE INSTITUTE OF
Chartered Accountants
IN IRELAND

CL 38

21st April 2004

Colin Fleming
International Accounting Standards Board,
30, Cannon Street,
London EC4M 6XH
United Kingdom

Dear Mr Fleming,

Response of the Accounting Committee of the Institute of Chartered Accountants in Ireland to the IASB Exposure Draft - ED 6 Exploration for and Evaluation of Mineral Resources

The Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland has considered ED 6 on Exploration for and Evaluation of Mineral Resources. The AC supports the IASB in its desire to address the issues comprehensively in the longer term and to issue limited guidance in the interim.

As can be seen from the answer to Question 3, AC has concerns regarding the proposed use of an IAS 36 type impairment test based on a 'cash generating unit for exploration and evaluation assets'. AC understands the appeal of being able to redefine the meaning of a cash generating unit and then making the entities subject to IAS 36. Unfortunately AC foresees a number of problems with this approach. These are as follows:

- An entity that operates only in exploration and evaluation may not have adequate cash flows from continuing operations to underpin its exploration and evaluation assets, while another entity with very similar exploration and evaluation assets may be able to do so because it has adequate, but unrelated, cash flows. AC believes that this proposed approach would be inequitable and would be likely to favour larger entities over smaller ones.

- AC believes that the concept of cash generating units representing independent streams of income should not be corrupted. Cash flows that are truly independent of each other should not be used to justify the carrying amount of assets to which they do not relate.

Proposed alternative interim approach

AC believes that exploration and evaluation assets should be subject to the impairment principle in IAS 36 but not to the specific method of assessing 'recoverable amount' in IAS 36. The commercial viability and technical feasibility of a project cannot be expected to be reliably assessed at the exploration and evaluation stage and, consequently, neither can the projected cash flows. The proposed standard should not require a particular method of assessing impairment but should, instead, require the financial statements to explain the criteria used for assessing impairment.

In order to improve the understanding of users of financial statements, AC would propose additional disclosures be imposed in relation to such assets. These would include:

- Separate identification of 'exploration and evaluation assets' from 'projects under development' or 'projects held for sale in accordance with IFRS 5'
- Analysis of exploration and evaluation assets by 'project' or 'area of interest' and for each such pool to show:
    - The movement in the period (ie, opening, expenditure made, transferred to development, transferred to held for sale, written off, closing balance)
    - The number of years during which exploration and evaluation activities have been undertaken, and
    - The estimated number of years to final determination of the evaluation activities.

Specific questions

The answers to the specific questions asked in the Exposure Draft are set out in Appendix I to this letter.

Longer term project

Apart from the obvious asset recognition issues involved in mining activities, AC suggests that the longer term project should also provide guidance on determining depreciation of assets once development has commenced. There is a wide range of possibilities from proven reserves, through probable reserves to possible reserves. AC would support proven reserves with a reassessment as additional reserves are proven.

AC would be happy to discuss or expand on any of the above issues with you.

Yours sincerely,

Simon Magennis
Secretary
Accounting Committee
Institute of Chartered Accountants in Ireland

APPENDIX I

The following are the responses of the Accounting Committee to the questions included in ED 6

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).

AC agrees with the definition of 'exploration for and evaluation of mineral resources', 'exploration and evaluation expenditures' and 'exploration and evaluation assets'. As explained below under Question 3, AC has some concerns regarding the definition of a 'cash-generating unit for exploration and evaluation assets'.

AC supports the guidance given in paragraph 7 of expenditures that may be included in the initial measurement of 'exploration and evaluation assets'.

Paragraph 8 identifies two types of expenditure that should not be included in the initial measurement of 'exploration and evaluation assets'. These are administration and other general overheads and development expenditure. AC considers that it would be preferable to deal with these items in separate paragraphs as they are excluded from the definition on different grounds and, in accordance with other IFRS requirements, would be subject to different accounting treatments. It would be preferable if paragraph 8A dealt firstly with administration and other general overheads and required them to be expensed in the period in which they were incurred. Paragraph 8B could then address development expenditure more fully. AC presumes that the extractive industries should apply the general principles of IAS 38 revised (paragraphs 57 to 64) to its development phase expenditures. However, this leaves open the question as to the presentation and measurement of exploration and evaluation assets relating to projects entering the development phase. The proposed standard should address the treatment of 'successful' exploration and evaluation activities and require that they be reclassified as development assets and subject to the impairment and disclosure requirements of IAS 38.

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 requirement and guidance an entity should consider in developing an accounting policy of 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 exploration and evaluation expenditures by permitting and alternative treatment for the recognition and measurement of exploration and evaluation assets. In particular, the draft IRFS 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 IAS8 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?

On the basis that this is an interim measure and that the IASB does not want to impose significant changes on a company now and then further changes when the longer term project is completed, AC supports the approach of allowing a company to continue to use its existing accounting policies. However, AC believes that a consequence of this should be increased disclosure. The answer to Question 5 sets out the additional disclosure that AC believes should be made in relation to exploration and evaluation assets.

Question 3 – Cash-generating units for exploration and evaluations assets

[Draft] IAS 36[1] 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 [draft] IAS36. 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 [draft] IAS36, what criteria should be used to assess the recoverability of the carrying amount of exploration and evaluation assets?

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1 In Exposure Draft of *Proposed Amendments to IAS36, Impairment of Assets and IAS 38 Intangible Assets* (December 2002)

IAS 36 impairment type tests are very difficult to apply to ‘exploration and evaluation assets’. By the very nature of these assets, there is great uncertainty associated with future cash flows from the assets. Exploration and evaluation expenditures are incurred during the ‘research stage’ (as defined in IAS 38 paragraphs 48-49) of a project and neither the commercial viability nor technical feasibility has yet been confirmed. Consequently, as explained in BC18, the normal impairment test of IAS 36 would be inappropriate.

The approach adopted in the Exposure Draft is to define a different cash generating unit to be used to assess the recoverability of exploration and evaluation activities. By permitting the entity to determine a bigger ‘cash generating unit for exploration and evaluation assets’ some entities will be able to perform an impairment test using cash flows from continuing operations to justify the carrying amount of the assets. This extended cash generating unit is permitted to be as large as a segment identified under IAS 14.

AC has some concerns with this approach, which are outlined in the following paragraphs.

- The approach effectively means that an enterprise can carry exploration and evaluation assets, without recognising an impairment, provided that it has sufficient cash flows from other activities to substantiate the carrying amount. This will be much easier for larger companies to do than for smaller companies. Segment size can vary significantly between entities and paragraph 35 of IAS 14 requires reportable segments to be identified if they represent more than 10% of assets, results or revenue. This may mean that Company A and Company B exploring side by side in an area of the world and having incurred the same exploration expenditure with identical potential for success may have to take a different view of the impairment required to be booked because of the size of other activities that can be grouped in to the segment. This does not appear to be reasonable.

- Some companies operating as exploration and evaluation companies do not continue to develop the sites once they have concluded on the existence of resources. They may ‘sell’ or ‘lease’ the development to another entity and simply retain a right to residual royalties. Under the proposal, it would be unlikely that such entities would be able to avoid an impairment of their other exploration and evaluation assets. This would be inconsistent with entities that develop the sites, thus generating a ‘continuing cash flow’ which would reduce or eliminate the need to recognise an impairment of other exploration and evaluation assets.

- The concept of allowing cash inflows generated by other assets to support the carrying value of perhaps unrelated exploration and evaluation assets is contrary to the generally accepted view that an asset should be assessed individually (unless it is cash generating only in conjunction with related assets). It appears inequitable that the existence of other cash flows should determine whether or not an entity needs to record an impairment.

AC acknowledges the need for entities to consider the carrying value of their exploration and evaluation assets at each year end and to form a view as to their expected recoverability. However, AC questions whether an IAS 36 style assessment based as it is on 'cash generating ability' should be used to assess assets which by their nature arise before it is possible to assess their cash generating ability.

The question as to whether such assets should be recorded as assets is a question for the longer term project. However, in the meantime AC believes that entities should be required to assess their carrying value at each year end and where there is significant doubt about the future recoverability of the amount an impairment should be recognised. The accounting standard should not specify the basis of this assessment but the financial statements should be required to provide details of the assessment process used.

The financial statements should additionally be required to provide more detailed information to users on the exploration and evaluation assets included in the balance sheet. This information could perhaps analyse the exploration and evaluation assets by 'area of interest' or 'project' showing the opening carrying value of the asset, movements in the period, the closing value of the asset, the number of years since exploration started and an estimate of the time remaining until final determination as to whether the project is suitable for development.

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 [draft] IAS 36 that an entity would consider when identifying whether such assets might be impaired (paragraph 13 and paragraphs BC24-BC26 of the Basis for Conclusions).

Are the 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 such assets might be impaired, what indicators should be used and why?

Subject to the comments above on the type of impairment test to be used, AC agrees with the list of additional indicators provided in the draft standard.

Question 5 – 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 (proposed paragraph 15 and 16 and paragraphs BC32-BC34 of the Basis for Conclusions).

Are the proposed disclosures appropriate? If not, why not? Should additional disclosures be required? If so, why are they and why should they be required?

As indicated above, AC agrees with the disclosures set out in paragraph 16 (a) and (b). AC believes that paragraph 16 (c) should require disclosure of the method the entity uses to assess impairment.

The enterprises should additionally be required to identify the exploration and evaluation assets included in the financial statements separately from development assets. The exploration and evaluation assets should be further analysed by 'area of interest' or 'project' showing the opening carrying value of the assets, movements in the period, the closing value of the asset, the number of years since exploration started and an estimate of the time remaining until final determination as to whether the project is suitable for development.

Providing information in relation to the time the 'project' has been in the evaluation stage and the expenditure in the year on the project together with an estimate from the directors as to how long they estimate evaluation will continue gives the reader of the financial statements a better appreciation of the quality of the evaluation asset and its priority for the company.