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Der Standardisierungsrat

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Sir David Tweedie
Chairman of the
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30 Cannon Street

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Berlin, 6 April 2004

**COMMENT LETTER – ED 6**

Dear Sir David

**ED 6 Exploration for and Evaluation of Mineral Resources**

We appreciate the opportunity to comment on the draft International Financial Reporting Standard *Exploration for and Evaluation of Mineral Resources*.

***General remarks:***

Since accounting for expenditures for the exploration for and evaluation of mineral resources is excluded from the scope of IAS 16 and IAS 38, we support the Board's intention to provide a minimum of temporary guidance avoiding fundamental changes in the entities' current accounting practices which may need to be modified again when a comprehensive standard on the accounting for extractive activities will be approved. ED 6 clarifies that entities may temporarily continue most of their current accounting practices for expenditures which arise from the exploration for and evaluation of mineral resources also with the first time adoption of IFRS in 2005. With ED 6, the Board provides a pragmatic solution avoiding several major changes of accounting rules within a short period.

However, though we acknowledge that a conceptually sound standard on extractive activities cannot be approved until 2005 we regard ED 6 solely as a stepping-stone to a long-term solution. We strongly support the objective of developing high quality International Financial Reporting Standards that will improve the transparency and comparability of financial statements worldwide. Thus, in our view developing a comprehensive financial reporting standard for extractive activities is one of the priority projects beside the development of a financial reporting standard for insurance contracts. Losing time, accounting differences in this area will remain in place for a long-term period.

Furthermore, the preceding discussion on the accounting of expenditures from exploration for and evaluation of mineral resources gave us reason for concern that the Board intended to develop a Standard for extractive industries rather than extractive activities. Particularly against the background that, discussing the insurance project, the Board expressed its intention of finding solutions for activities rather than for industries, we would regard an accounting standard concerning the specific characteristics and risks of the extractive industries as highly problematic.

***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 excluded 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).

**GASB's comment:**

We strongly support the initial measurement of exploration and evaluation assets at cost (paragraph 6). However, in our view the scope of expenditures that may be included in the initial measurement of exploration and evaluation assets (hereafter referred to as "E & E" assets) seems to be too wide.

The proposed possible elements of E & E assets in paragraph 7 are necessary in order to distinguish them from expenditures with similar characteristics. Although

E & E activities are excluded from the scope of IAS 16, and IAS 38, we recommend providing an identical treatment for comparable expenditures, i.e. for E & E on the one hand and Research & Development on the other. The IAS 38, Intangible Assets, distinguishes between research expenditures and development expenditures that shall be included in the initial measurement of an intangible asset. A comparison of the characteristics of the expenditures proposed in paragraph 7 with the characteristics of expenditures for development included in an intangible asset according to IAS 38 might lead to a more precise delimitation between exploration and pre-exploration expenditures. Pre-exploration expenditures should not be included in the initial measurement, comparable to research expenditures according to IAS 38.

The Basis for Conclusion points out that entities may continue to classify exploration and evaluation assets in accordance with the accounting policies applied in their most recent annual financial statements (either as tangible or intangible). We would appreciate this statement being incorporated into the main body of the Standard..

***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?

**GASB's comment:**

a) In general, the Exposure Draft allows two different approaches with respect to exploration for and evaluation of mineral resources: Either an entity develops an accounting policy based on IAS 8, paragraphs 10-12, or it continues the use of accounting policies applied in its most recent annual financial statements. In our view, it is not clear enough as to which particular provision or paragraph of the Exposure Draft has to be applied under the two approaches:

   Paragraph 4 states that an entity may elect to continue to recognise and measure E & E assets in accordance with the accounting policies it applied in its most recent annual financial statements, except as provided in paragraph 8.

   We believe that the reference to paragraph 8 is not sufficient. Instead, according to our understanding reference should be made to paragraphs 6-10 in this case: BC32 states that the Board noted that an entity that elects not to continue to apply the accounting policies applied for its most recent annual financial statements for the exploration for and evaluation of mineral resources (i.e. an *entity* that is required to apply the criteria in *paragraphs 10-12 of IAS 8*) *should not apply* paragraphs 4-10 of the draft IFRS by analogy. Therefore, *paragraphs 4-10 of the draft IFRS* must be *intended to be applied* by entities that elect to use the accounting policies applied for their most recent annual financial statements.

   Concerning the application of paragraph 8 to entities, which continue to measure E & E assets in accordance with the former accounting policies, we are not sure how to deal with E & E assets including expenditures provided in paragraph 8. Should paragraphs 4 and 8 of ED 6 be applied retrospectively or prospectively?

   Furthermore, we suggest that the Board explicitly set out that the provisions regarding impairment (except for the definition of the relevant cash-generating unit) and disclosure are mandatory for both approaches mentioned above.

   In order to avoid misunderstandings, section headings and paragraph titles should be aligned with the content of the related paragraphs. For example, paragraphs 4 and 5 deal with recognition and measurement. In our view, an appropriate heading in this case would be "Accounting Policies concerning Exploration and Evaluation Assets".

b) We accept the proposals as an interim solution until the IASB issues new or revised Standards that encompass such activities. However, as set out in our general remarks, we consider the development of an appropriate accounting standard for E & E activities as important in order to avoid exemptions for certain activities from the overall approach of IFRSs in the long run.

***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 based on a 'cash-generating unit for exploration and evaluation assets' rather than the cash-generating unit that might otherwise be required by [draft] 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 [draft] IAS 36, what criteria should be used to assess the recoverability of the carrying amount of exploration and evaluation assets?

**GASB's comment:**

We agree with the Board's proposal requiring an impairment test according to IAS 36 on E&E Assets.

Against the background, that ED 6 gives a wide scope of recognising expenditures for exploration of and evaluation for mineral recourses, we are of the opinion that a more restrictive definition of cash-generating units for the impairment test of E&E assets would be appropriate. Appendix A limits the maximum size of a cash-generating unit for E & E assets to a segment (according to IAS 14 a business or a geographical segment). At the same time, paragraph 13 provides guidance on identifying assets with a focus on "specific areas". We would recommend providing additional guidance on the limitation of a "specific area" such as a concession or a field.

We are concerned that creating the notion of a special cash-generating unit as proposed in ED 6 may give the reporting entity an extensive scope of discretion for recognition as well as for measurement of E&E assets. We see the problem that this could lead to a lack of transparency and particularly of comparability within the extractive industry as well as with entities of other industrial sectors. Therefore, we recommend reconsidering the proposals on the impairment test and the definition of cash-generating units of E&E assets.

***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 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 such assets might be impaired what indicators should be used and why?

**GASB's comment:**

We consider the indicators of impairment, which are proposed in paragraphs 9-13, appropriate and we are not aware of additional indicators that should be used.

***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-BC34 of the Basis for Conclusions).
Are these proposals appropriate? If not, what changes would you propose and why?

**GASB's comment:**

We regard the proposed disclosures as appropriate. Nevertheless, since expenditures for exploration of and evaluation for mineral resources represent a substantial cost to entities engaged in extractive activities, we would appreciate some additional disclosures in order to prevent negative effects from the continuation of different accounting policies for the interim period. In our view disclosure about the elements of exploration and evaluation assets as set out in paragraph 7 of ED 6 would be important for users of financial statements in order to assess the effects of accounting policies, which possibly contravene the IASB Framework. Regarding the uncertainty of future cash inflows (timing and amount) from the exploration of and evaluation for mineral resources, disclosure about the assumptions and other sources of measurement and the immanent risk may be useful as well. In particular, when an entity chooses the revaluation model according to paragraph 10 of ED 6 to its (tangible and intangible) E&E assets, disclosures according IAS 16 or IAS 38, i.e. especially the underlying assumptions of fair value measurement, are necessary.

If you would like any clarification of these comments, please contact me.

Yours sincerely,

*Prof. Dr. Klaus Pohle*
President