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AA plc

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Dear Mr Flemming,

COMMENTS ON ED 6: EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

Thank you for the opportunity to provide our comments on the Exposure Draft and the related Basis for Conclusions. This letter sets out our general comments on the proposed standard, and in particular provides answers to the specific questions raised, which are set out in Appendix I.

In summary, we have two main reservations concerning the guidance within the Exposure Draft:

1. Changes to existing accounting practices; and
2. Impairment testing in accordance with IAS 36.

1. Changes to existing accounting practices

Anglo American Group acknowledges the intended purpose of ED 6 in providing temporary accounting guidelines for companies reporting under International Financial Reporting Standards (IFRS), in particular for first-time reporters.

By allowing companies to continue their past accounting practices, the Exposure Draft should help avoid any unnecessary disruption caused by short-lived policy changes in an area that is still the subject of a comprehensive project by the International Accounting Standards Board (IASB).

However, one of the objectives of companies reporting under IFRS should be for them to choose the most appropriate accounting policies that ensure reported results are relevant and reliable [IAS 8, paragraph (10)].

Although paragraph 11 in the Exposure Draft permits companies to continue applying their previous accounting policies for exploration and evaluation assets, the Exposure Draft requires any **changes** to existing policies to be performed in accordance with IAS 8, paragraphs 11 and 12. This may prevent a company from switching to a more appropriate industry recognised practice if the policy isn’t clearly supported by the existing International accounting framework.

We believe companies should be able to use other industry-accepted practices when choosing accounting appropriate accounting policies, especially in the absence of the completed project on international accounting in the Extractive Industry.

We highlight the need for clear guidance concerning the accounting for Exploration and Evaluation (E&E) costs in the extractive industry and trust that the IASB is progressing the existing project with high priority. Allowing past accounting practices to continue will not achieve the ultimate goal of consistency and comparability between companies reporting under IFRS, as industry practices in the extractive industry may differ widely.

2. Impairment testing in accordance with IAS 36

We raise real concerns over the attempt to apply the existing IAS 36 impairment framework to capitalised E&E costs, albeit with modifications in the form of an extended definition of “cash generating unit for exploration and evaluation assets”.

E&E assets cannot always be attributed to an existing cash generating unit (CGU). This would be especially an issue for junior miners, or for exploration activity in new geographical areas. In these instances, application of IAS 36 may lead to an “arbitrary” allocation of assets to existing CGUs and the supporting of assets with unrelated cash flows. As such, costs could be written off prematurely, or assets may be held which would normally, under existing industry practices, be written off.

Some E&E assets, by their very nature, are subject to a high degree of probability and would require significant future development costs to prove up and extract potential resources. It is unlikely, therefore, that such E&E assets could be supported by an IAS 36 impairment test that requires future risk-adjusted cash flow estimates for the asset in its current condition [IAS 36 (56), (44)].

In the absence of a final standard for international accounting in the Extractive Industry, we would rather adhere to current industry practices, which require an annual review or assessment for impairment, performed at an “area of interest” or similar level. Such an assessment considers the intention for future exploration and probable development, as indicated by existing exploration budgets, expected commodity prices, preliminary results from geological surveys, and other similar guidance as detailed in paragraph 13 of the Exposure Draft.

We thank you for considering our comments in the development of this accounting standard.

Kind regards.

Juliet Wall
Head of Corporate Financial Accounting, AA plc

Appendix 1 – Responses to specific questions within the Exposure Draft

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).

1. We believe the definitions provided in Appendix A of the Exposure Draft appear appropriate. Going forward, relevant definitions should be formulated by specialists in the field that would be generally accepted by extractive industries worldwide.

2. We do not agree with the definition of “cash-generating unit for exploration and evaluation assets”. See specific comments under Question 3, below.

3. We broadly agree with guidance provided in paragraphs 7 and 8 of the Exposure Draft over what may and may not be included in the initial measurement of E&E assets. However we feel it should be made clear that this is only **guidance** and is not to be interpreted as an exhaustive list.

4. We believe a distinction should be made between the administration and general overhead costs (Exposure Draft paragraph 8) excluded from initial measurement of E&E assets and administration and overhead costs that are directly related to an exploration interest, which we would expect to be included as E&E assets.

Question 2 – Method of accounting for exploration for and evaluation of mineral resources

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.

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?

1. We agree that as an **interim measure**, companies should be able to apply paragraph 4 of the Exposure Draft, and 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.

2. We highlight the need for clear guidance concerning the accounting for E&E costs and recognition of assets in the extractive industry and urge the IASB to progress the existing project with high priority. Allowing past accounting practices to continue will not achieve the ultimate goal of consistency and comparability between companies reporting under IFRS, as industry practices in the extractive industry may differ widely.

3. We do not agree with proposals for accounting policy changes, as set out in paragraph 11 and BC12 of the Exposure Draft.

4. Application of paragraph 11 of the Exposure Draft may prevent a company from switching to an alternative industry recognised practice, even if they consider it to be more appropriate than their existing policy. This may be the case if guidance in International Standards and Interpretations eg. IAS 38 *Intangible Assets*, or asset definitions within the IASB framework, do not support industry alternative policies due to uncertainty of future cash flows eg. capitalising rather than expensing green-field E&E costs, or switching from "full-cost" to "successful efforts" method of accounting for Oil and Gas companies.

5. We believe, in the absence of conclusions from the full project on the Extractive Industry, accounting policy changes should not be made exclusively in accordance with IAS 8 paragraphs 11 and 12, but that companies should be able to use other accepted industry practises if they consider these to be more appropriate than their existing policies.

6. We question the appropriateness of paragraph 10 of the draft standard, which permits an entity to apply either the cost model or the revaluation model to E&E assets after initial recognition.

7. Permitting companies to revalue assets, the recognition of which is already of concern under a strict application of International Standards and the IASB framework, is likely to exacerbate the problem.

8. IAS 16 paragraph 31 states that in order to carry assets at a revalued amount, the fair value must be "reliably" measured. It goes on to suggest using market-based evidence, or if that is not available, an income approach, amongst other methods. The nature of most E&E assets would surely preclude the ability to "reliably" measure an appropriate fair value eg. due to uncertainty surrounding quantification of resource and reserves, likelihood of subsequent development and ability to predict future production costs and final commodity prices. We note it is for similar reasons we raise concerns over the requirement to perform an annual impairment assessment in accordance with IAS 36 (refer to Question 3 response, below).

9. We would prefer a policy that applies only a cost model to such assets.

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

[Draft] 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 [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?

1. We raise real concerns over the attempt to apply the existing IAS 36 impairment framework to capitalised E&E costs, albeit with modifications in the form of an extended definition of "cash generating unit for exploration and evaluation assets" (CGUEE).

2. Such an allocation may be appropriate if extending an existing mine, however capitalised E&E costs cannot always be attributed to an existing CGU. This would be especially an issue for junior miners, or for exploration costs incurred in new geographical areas.

3. In these instances, application of IAS 36 may lead to an "arbitrary" allocation of assets to existing CGUs and the supporting of assets with unrelated cash flows: costs could be written off prematurely, or assets may be held which would normally, under existing industry practices, be written off.

4. Currently some miners may assess E&E assets for impairment at a lower level than is currently required under the Exposure Draft. Fitting the impairment test into such an IAS 36 mould, with CGUEE limits allowed up to an IAS 14 segment level, could actually lead to assets being carried forward that may previously have been written off.

5. Some E&E assets, by their very nature, are subject to a high degree of probability and would require significant future development costs to prove up and extract potential resources. It is unlikely, therefore, such E&E assets could be supported by an IAS 36 impairment test that requires future **risk-adjusted** cash flow estimates for the asset in its **current condition** [IAS 36 (56), (44)].

6. Certainly in the short-term, in the absence of conclusive accounting guidance for the Extractive Industry, we would rather adhere to current industry practices, which require an annual review or assessment for impairment, performed at an “area of interest” or similar level. Such an assessment considers the intention and likelihood of future exploration and probable development as indicated by existing exploration budgets, expected commodity prices, preliminary results from geological surveys, and other similar guidance as detailed in paragraph 13 of the Exposure Draft.

7. In the medium to long term, IAS 36 could be modified so that the impairment assessment of E&E assets would require different assumptions than those currently included for tangible assets or for goodwill.

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?

1. We believe that paragraph 12 of the Exposure Draft, requiring an annual impairment test, is confusing in light of paragraph 13, which provides a list of “trigger” events to indicate the **requirement** for an impairment test.

2. The draft standard should clarify if an impairment assessment is required annually, or only when evidenced by a trigger event.

3. That aside, the existing items listed in paragraph 13 appear appropriate as indicators that E&E assets may be impaired.

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 paragraphs 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, what are they and why should they be required?*

1. We agree with the proposed disclosures set out in paragraph 15 of the Exposure Draft.

2. We welcome the requirement for detailed disclosure of accounting policies covering the recognition, measurement and impairment of E&E assets, as under interim guidance provided by the Exposure Draft, these policies may vary widely within the industry.

3. Additional guidance is required as to whether a profitable sale of E&E assets that had previously been impaired, should reflect first a write back of the impairment giving rise to a smaller gain on disposal, or whether the write back is incorporated in the net gain or loss calculation, without separate disclosure.