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IASBriefing

IASB*riefing* – Extractive industries special issue

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This is a special issue of the IASB*riefing* that provides a summary of the proposals in the IASB's recently published exposure draft ED 6 *Exploration for and Evaluation of Mineral Resources*.

Overview

On 15 January 2004 the IASB published ED 6, an exposure draft on *Exploration for and Evaluation of Mineral Resources*. Currently, expenditures on exploration and evaluation activities are excluded from the scope of existing IFRS that otherwise would be relevant. ED 6 proposes that entities be permitted, but not required, to retain the accounting policies applied to their most recent annual financial statements for the recognition and measurement of exploration and evaluation assets until the IASB progresses a longer-term comprehensive extractive industries project.

Background

Accounting for extractive industries has been on (and off) the agenda of the IASB and its predecessor, the International Accounting Standards Committee (IASC), since 1998. 'Extractive Industries' encompasses activities generally described as oil and gas and mining. To date, the IASB has not distinguished mining from oil and gas.

In 2000, the IASC issued an Issues Paper *Extractive Industries*. This paper identified diversity in practice under national GAAPs as well as a number of issues where the current requirements of IFRS are unclear regarding typical extractive industry activities. However, the IASB did not add a project to its active agenda to follow up on this discussion paper. Instead, the IASB formed a sub-group of national standard setters and led by the Australian Accounting Standards Board, including Canada, Norway and South Africa, to consider these issues and provide assistance for entities applying IFRS for the first time in 2005. While these proposals provide an exemption to entities so that they may not be required to change their accounting policies for exploration and evaluation activities twice, entities in this industry may continue to produce financial reports that may not be easily comparable.

KPMG's bi-monthly update on International Financial Reporting Standards (IFRS)

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Recognition

ED 6 proposes that entities be permitted, but not required, to retain some of their current accounting policies. This 'grandfathering' is conditioned largely on the use of either an entity's current accounting policies or an accounting policy that results in more relevant and reliable information to the users of the financial statements in relation to the IASB *Framework*. An entity could not change its accounting policy to one that resulted in less relevant and reliable information in relation to the *Framework*, even if the desired policy was eligible for 'grandfathering' by another entity. Changes in accounting policies are discussed further below.

ED 6 would allow entities to treat exploration and evaluation expenditures as either a fixed asset, using IAS 16 *Property, Plant and Equipment*, or as an intangible asset under IAS 38 *Intangible Assets*. Therefore, recognised exploration and evaluation assets may be measured at cost or at fair value, using the revaluation option in IAS 16, depending upon how the asset is classified by the entity under its current policy.

However, 'grandfathering' of previous accounting policies is limited by providing a strict definition of qualifying exploration and evaluation expenditures, which may differ from an entity's current practices. ED 6 specifies that exploration and evaluation expenditures include acquisition of rights to explore; topographical, geological, geochemical and geophysical studies; exploratory drilling; trenching; sampling; and activities in relation to evaluating technical feasibility and commercial viability of extracting a mineral resource. This definition **excludes** administrative and other general overhead costs, and therefore the current accounting treatment of these costs would fall *outside* ED 6's option to 'grandfather' existing policies.

Impairment

ED 6 offers two options for how to group exploration and evaluation costs when performing impairment tests. Entities can group their assets according to the existing definition of a cash-generating unit (CGU) in IAS 36 *Impairment of Assets*, or a CGU for exploration and evaluation assets (CGU-EEA).

A CGU-EEA is defined as the smallest identifiable group of assets that, together with exploration and evaluation assets, generates cash inflows from continuing use, and for which impairment tests were performed by an entity under the accounting policies applied in its most recent annual financial statements. However, a CGU-EEA cannot be larger than a segment as defined in IAS 14 *Segment Reporting*.

It is likely that estimating the recoverable amount of exploration and evaluation assets based on the normal (IAS 36) definition of a CGU will result in more exploration and evaluation assets being impaired and written off than if the CGU-EEA were used. It appears that entities will be eligible to group assets in a CGU-EEA *only* if their previous accounting policy required exploration and evaluation assets to be tested for impairment.

Where the entity elects to use the CGU-EEA, it first must test any assets *other* than capitalised exploration and evaluation expenditures included in the CGU-EEA using the requirements of IAS 36. The process proposed is as follows:

- assets other than exploration and evaluation assets are tested for impairment using the appropriate CGU;
- any impairment of these assets is recognised;
- exploration and evaluation costs are tested for impairment together with any other assets included in the CGU-EEA; and
- any resulting impairment loss is recognised as an impairment of the exploration and evaluation assets.

ED 6 requires capitalised exploration and evaluation costs to be tested for impairment where an impairment indicator exists. The proposals add specific additional impairment indicators for exploration and evaluation assets.

Change of accounting policy

ED 6 proposes that entities can change their previous accounting policies for exploration and evaluation assets if, and only if, the change makes the financial statements more reliable and more relevant to the decision-making needs of users, judged by the criteria in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

This condition is similar to the wording agreed by the Board in respect of ED 5 *Insurance Contracts* in that entities would be permitted to change their accounting policies if the change moves their accounting treatment *closer* to the *Framework*. First-time adopters also would be eligible to change their accounting policy upon adoption of IFRS, *if* the new policy is *more* consistent with the *Framework*. It is important to note the distinction between moving *closer* to and *satisfying* directly the IAS 8 requirements for consistency with the *Framework* and general principles. In effect, the language used in ED 6 (and in respect of ED 5) permits changes to adopt policies that in absolute terms would not be acceptable.

Future developments

The IASB has included a comprehensive project addressing extractive industries on its research agenda. It is unlikely that this project will lead to an exposure draft replacing ED 6 (and possibly addressing other extractive industry issues) for some time. It is difficult to predict what direction a comprehensive project may take.

Effective date

ED 6 applies to reporting periods starting on or after **1 January 2005**, but earlier adoption is encouraged.

Comment deadline

The comment period closes on **16 April 2004**.

If you would like further information on any of the matters discussed in this IASB*riefing*, please talk to your usual contact at KPMG or call any of our offices.

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