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15 April 2004

Sir David Tweedie, Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sir David,

**Exposure Draft ED 6, Exploration for and Evaluation of Mineral Resources**

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's (the Board's or IASB's) Exposure Draft—ED 6 *Exploration for and Evaluation of Mineral Resources* (referred to as ED 6 or the draft standard). Our responses to the questions raised in the Exposure Draft and comments on specific matters of concern are set out in the Appendix to this letter.

While we applaud the IASB for its efforts to address accounting for the exploration for and evaluation of mineral resources, we question the approach taken in ED 6. That is, to develop an “interim standard” that exempts entities within the scope of the draft standard from complying with certain parts of the Framework and defers addressing recognition and measurement principles until a later date. We do not believe this approach should be precedent for future projects. In contrast, we would prefer that the IASB address these issues as part of a comprehensive project involving the development of proper recognition and measurement principles for the extractive industries.

We understand the IASB's desire to finalise as many of its projects prior to the implementation of International Financial Reporting Standards (IFRS) in Europe. Consequently, we accept the need to provide some interim guidance on the accounting for exploration for and evaluation of mineral resources before a final standard on recognition and measurement principles is completed. Accordingly, we support the development of ED 6 into an International Financial Reporting Standard until such time as the IASB's comprehensive project can be completed.

We are concerned that the introduction of the draft standard may compromise the principles of many jurisdictions in accepting IFRS – that is that a ‘level playing field’ will be established in global capital markets. The ability of entities to apply a number of different accounting policies to the same fact pattern, dependent on their policies prior to the introduction of the


standard is not consistent with the establishment of consistent worldwide financial reporting practices.

We note that in some industries and jurisdictions full expensing of all exploration and evaluation costs is the preferred methodology. We note that some industry participants would prefer this approach to be mandated by the IASB as they believe this to be the more conceptually correct approach. We believe such a decision would prejudge the results of a more thorough examination of the issues and would encourage the IASB not to mandate this approach prior to the completion of the comprehensive project. We would however, encourage the IASB to give greater priority to a comprehensive project than is currently the case so as to reduce the period of use of a standard that allows considerable choice and could consequently be considered to be a lower quality standard. We would also encourage the IASB to complete this project in conjunction with standard-setters from other jurisdictions that have had accounting pronouncements on these issues for some time.

Furthermore, we believe that the application of the draft standard to only address exploration and evaluation activities does not address other significant issues that arise in the extractive industries, such as accounting for development activities, for which guidance would be useful to ensure consistent information.

If you have any questions concerning our comments, please contact Ken Wild in London at (020) 7007 0907.

Sincerely,

*Debbie Touche Robinson*  


**Appendix**  
**Comments of Deloitte Touche Tohmatsu on**  
**Exploration for and Evaluation of Mineral Resources**

**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).*

We note that standard setters around the world that have endeavoured to address the issue of accounting for the extractive industries have generally defined exploration activities separately from evaluation activities. Such separate definitions are appropriate to reflect the very different risk profiles of exploration assets (where a potential resource has not been identified) versus evaluation assets (where resources have been identified and decisions as to whether the resource can be commercially exploited, and if so, how best to exploit those resources, are being considered).

Exploration

We do believe that when considered as a separate definition ‘the search for mineral resources, including mineral, oil, natural gas, and similar non-regenerative resources’ is appropriate

Evaluation

We believe that when considered as a separate definition ‘the determination of the technical feasibility and commercial viability of the extracting the mineral resource before the decision to develop the mineral resource’ is appropriate. Consistent with other IFRS standards (e.g. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*), some guidance should be provided on what constitutes a ‘decision’ that would change the accounting methodology. Such guidance should focus on ensuring entities choose a consistent point where evaluation is considered to be complete and development is ready to begin. Without this guidance, entities may choose arbitrary points that may lead to non-comparability in relation to applying other IFRSs between entities in the extractive industries.

Therefore, guidance on what constitutes development activities should also be provided in the standard. This will assist entities in determining whether they should apply the provisions of the draft standard or comply with other IFRS pronouncements. For example, in an underground mining operation, some entities may consider the costs of the initial stage of a decline or shaft as part of evaluation activities, whereas others might consider this to form part of the development activities.

Guidance

We consider that the guidance in paragraph 7 is incomplete, in that it provides a number of specific examples of exploration type activities, but provides no guidance on what might constitute ‘activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource’. Item (f) of paragraph 7 repeats the wording in the definition and does not provide guidance on its interpretation. We believe it would be more useful to provide guidance on types of evaluation activities that fall within the definition, and we suggest the use of the following examples: determination of the volume and grade of the

mineral resource, determination of appropriate extraction methods and treatment processes, and consideration of infrastructure requirements.

**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 some 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 – BC 11 of the Basis for Conclusions).*

*Are these proposals appropriate? If not, why not?*

We support these proposals as an interim measure until such time as the IASB can complete its comprehensive project on the issues.

However, we are concerned that for entities that had inadequate or inappropriate accounting policies prior to the implementation of IFRS, the introduction of IFRS will not improve their financial reporting. Examples of such policies are where entities capitalised a certain proportion of costs based on their expectation of a successful outcome from the exploration and evaluation activities. Such policies are not consistent with the framework, and the draft standard encourages entities to continue applying such policies rather than to re-evaluate the appropriateness of their accounting policies. As noted in our covering letter, while we do not believe these outcomes are appropriate, we accept that they are necessary as a temporary measure until such time as a comprehensive project can be completed.

BC29 states that entities are encouraged to improve their accounting policies. We believe it will be very difficult to determine whether a proposed new accounting policy results in more relevant information (as required by IAS 8.14) in a period when no guidance is given as to what accounting policies provide relevant and reliable information in relation to the extractive industries. In particular, we are concerned that where existing accounting requirements in certain jurisdictions allow alternative treatments, it is not clear how to assess whether a change between the (currently) allowed alternatives would be considered an improvement in accounting policy. Consideration of the hierarchy of accounting pronouncements in IAS 8 would not assist users in concluding on the appropriateness of the change.

### **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 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?*

We agree that exploration and evaluation assets should be subject to an impairment test under [draft] IAS 36. We are however concerned by the proposed methodology, which might be interpreted to imply that the exploration and evaluation assets do not have a recoverable amount in their own right. Our understanding is that the draft standard requires, where the entity elects to test for impairment on the basis of a ‘cash-generating unit for exploration and evaluation activities’ that an entity assess a cash-generating unit for impairment under IAS 36 in the standard manner, and then to add the exploration and evaluation assets to the assets being tested. In completing a value in use analysis, the entity would typically add no supporting value in use to the originally assessed value in use of the CGU.

To illustrate our concern with the proposed approach assume entity A has determined that their cash-generating unit C, that is carried in aggregate at \$120 has a value-in-use of \$100. Accordingly, an impairment write-down of \$20 is recorded. The entity then adds on its exploration and evaluation ‘assets’ associated with their tenement of \$10 to do the ‘cash-generating unit for exploration and evaluation expenditure’ test. However, the ‘value-in-use’ of the cash-generating unit is still estimated to be \$100, accordingly an impairment loss should be recognised for the \$10 of exploration and evaluation costs.

As illustrated, wherever a cash-generating unit assessment has resulted in an impairment write-down under IAS 36, all exploration and evaluation costs subsequently added for the cash-generating unit for exploration and evaluation expenditure would automatically be required to be written off.

However many exploration and evaluation assets do have a recoverable amount in their own right, particularly if mineralization has been identified or the exploration rights are in prospective area or close to an existing operating mine or field. While there may not be an active market for the mineral exploration rights, the rights do still generally have some re-sale value. Where a binding sale agreement is in place, clearly a recoverable amount for these assets can be identified. The sale price of an ‘exploration and evaluation asset’ will reflect the aggregate value of the exclusive right to explore a particular area of land (including the strategic value of the location) and the accumulated exploration information gathered through exploration activities. This value will increase if mineralization is discovered on the area or in the immediate vicinity.

Assuming that the entity above has a tenement on which a successful discovery of minerals has been made, with the successful discovery resulting in the entity forming a binding sale agreement to sell the exploration and evaluation assets for \$10 (net of any selling costs). The entity could, when adding the cost of exploration and evaluation assets to the other CGU assets, add the net selling price of the exploration and evaluation asset to the originally assessed recoverable amount of the CGU. However, this may mean combining the value in use calculation from the CGU with the net selling price of the exploration and evaluation assets, which some believe is a conceptually flawed approach. Depending on the interpretation of IAS 36 combined with the draft standard, the following outcomes are possible

Total value-in-use CGU + net selling price EE Assets = \$110  
Therefore no write-down is required.

Total net selling price CGU (\$90) + net selling price EE assets = \$100  
Write-down of \$10 is required, but conceptually the \$10 to be written down is attributable to the other assets of the CGU – despite the fact that absent the exploration and evaluation assets the assets would not be required to be written down beyond \$100 as they are considered recoverable as a result of value in use testing.

Total value in use CGU + total value in use EE assets = \$100  
Write-down of \$10 is required because the exploration and evaluation assets are unlikely to have an identifiable value in use to be added into the calculation.

It is not clear to us from the draft standard which, if any, of the above alternatives is considered by the IASB to be permissible when applying the draft standard.

We accept that the implications discussed above may not be as pronounced for entities that are in relatively strong financial positions, however we believe the number of so-called ‘junior explorers’ in existence justifies the IASB giving further consideration to the appropriateness of the impairment testing proposals. Given the potential outcomes illustrated above, we are concerned that preparers may in some cases, take the most aggressive interpretation as to whether to write an asset down. We believe that an illustrative example of how the impairment test is expected to work in practice will assist users in interpreting the standard. We also believe the board should further clarify how an entity that has no cash-generating units (a ‘pure exploration’ company) would apply the requirements.

We note that the draft standard is unclear as to whether the impairment test must be carried out annually, or whether an assessment of the existence of indicators is carried out annually with an impairment test following only if indicators of impairment are identified. We encourage the IASB to provide some clarification on this point.

We are concerned as to the varied possible interpretations of the indicators listed in paragraph 13 (c) of the draft standard. We believe that a fall in the short term price of the commodity may cause some entities to believe that an indicator of impairment exists, while others may believe that an indicator of impairment does not exist following an analysis of the forward rates for the commodity in question. Further guidance as to how to apply the indicators would therefore be welcomed.

While we concur with the Board's assertion (BC20) that some discipline must be placed around the definition of a cash-generating unit for exploration and evaluation assets, we are not convinced that the requirement that a cash generating unit for exploration and evaluation activities be no larger than a segment is an appropriate solution. Where an entity is not required to identify segment information (i.e. equities or debt securities are not publicly traded) it is not clear whether the whole entity is then considered to be an acceptable cash-generating unit for exploration and evaluation assets or whether the standard effectively forces such entities into identifying segments in accordance with IAS 14.

In addition, we do not believe that where an entity does apply segment reporting that their segments necessarily constitute an appropriate cash-generating unit. This is particularly the case where entities have a separately disclosed 'exploration and evaluation' segment. Such disclosure is not uncommon in the extractive industries, as some entities may manage their businesses with separately reported exploration and evaluation divisions, and only allocate to an 'operating' business segments, when they have identified what, if any, mineral reserves are to be found on the tenement. In such cases, the draft standard would require only the exploration and evaluation activities to be included within the cash-generating unit and accordingly a 'value-in-use' calculation would not provide meaningful information.

Considering the difficulties we have identified with the segment approach, we believe the IASB should consider giving consideration to alternative approaches for identifying the maximum portion of an entity to be included in a 'cash-generating unit for exploration and evaluation 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 (paragraphs 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?*

We agree with the suggested indicators of impairment. However, we believe that the interpretation of point (f) 'the entity does not expect the recognised exploration and evaluation assets to be reasonably capable of being recoverable from a successful development of the specific area, or by its sale' is overly subjective. We believe that the indicator suggested at IAS 36.12(g) 'evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected' is more appropriate. Given the draft standard notes that all of the impairment indicators in IAS 36 should be considered in addition to those in the draft standard, we believe that indicator (f) should be deleted from 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 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?*

We agree that the proposed disclosures are appropriate. We believe that where an entity capitalises exploration and evaluation costs, a reconciliation of the opening balance of amounts capitalised to the closing balance of amounts capitalised should be required. This is consistent with other like assets such as property, plant and equipment, and intangible assets, and consistent with the requirements in respect of such assets comparative information should not be required.

### Additional Concerns

#### Limited Application

We also believe that the proposals are of limited benefit in achieving their intended objective because they apply only to exploration and evaluation activities. The original IASC discussion paper issued in 2000 discussed the accounting for the full range of activities in the extractive industries. As illustrated in the table below, existing IFRS contain a number of scope exclusions for entities operating within the extractive industries. We believe that the intention of the IASB on all of these issues should be clarified in the final standard.

Reference	Scope exclusion
IAS 16.3	This Standard does not apply to:… (b) mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.
IAS 17.1	This Standard should be applied in accounting for all leases other than: (a) lease agreements to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and
IAS 18.6	This Standard does not deal with revenue arising from:… (h) the extraction of mineral ore
IAS 38.1	This Standard shall be applied in accounting for intangible assets, except:… (c) mineral rights and expenditure on the exploration for, or development and extraction of, minerals, oil, natural gas and similar non-regenerative resources;…
IAS 40.3	This Standard does not apply to:… (b) mineral rights, the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative assets



Our understanding is that the draft standard proposes the retention of existing accounting policies only for exploration and evaluation activities. Therefore our understanding would be (given the scope exclusions above, and despite the amendments proposed by Appendix B of the draft standard) that entities must apply the hierarchy of accounting pronouncements proscribed in IAS 8 paragraphs 10 -12 in determining the appropriate accounting policy for the following items

- accounting for all extraction type activities
- accounting for all development activities in the extractive industries
- lease agreements to explore for or use minerals, oil, natural gas and similar non-regenerative assets
- revenue arising from the extraction of mineral ore

We believe that the above areas of accounting are quite complex, and do not see any reason why the effective exclusions from paragraphs 10 – 12 of IAS 8 should not be applied to these areas as well until such time as the IASB completes its comprehensive project. If the IASB has determined that the additional issues identified above are not required to be addressed, that should be made clear in the Basis for Conclusions. The Basis for Conclusions should also briefly address the appropriate accounting treatment for the above items, as some do not believe that the appropriate accounting methodology is immediately apparent.

#### Mandating the Measurement of Exploration and Evaluation Assets at Cost

Paragraph 6 of the draft standard proposes that exploration and evaluation assets be measured at cost. We believe that this may be interpreted to require that all exploration and evaluation expenditure should initially be measured at cost even though an impairment loss may immediately result, particularly if the election to use a ‘cash-generating unit for exploration and evaluation assets’ is not made. However, if the exploration and evaluation efforts are successful, the value of the exploration and evaluation asset may materially increase, and the requirements of IAS 36 would then effectively require the reversal of previous impairment losses.

Many entities operating in the extractive industries choose to recognise an expense for all exploration and evaluation expenditure, but these requirements may be seen to require the ‘reinstatement’ of this expenditure. Whilst the intention of paragraph 6 of the draft standard is somewhat unclear, we recommend that the Board consider including commentary that clarifies that ‘reinstatement’ is not intended where an entity’s accounting policy is to immediately expense exploration and evaluation expenditure as it is incurred.

#### Ongoing issues until completion of IASB’s comprehensive project

We have a number of specific concerns about the interim period between the implementation of this standard and the implementation of a standard arising from the Board’s comprehensive project.

We are concerned about the impact the draft standard will have on entities that start up in between the first time application of IFRS in their jurisdiction and the completion of the IASB’s project. We believe that they will be significantly disadvantaged in completing their financial reporting obligations. We believe that determining appropriate accounting policies in accordance with IAS 8 could be a time consuming and costly exercise, and do not believe this is an appropriate outcome. We suggest that start-up entities be permitted to apply

accounting requirements accepted for exploration and evaluation assets in their jurisdiction prior to the implementation of the draft Standard.

#### Effective date

While we believe the effective date is appropriate, we do not believe the assertion that the application of the draft standard will not result in any changes in accounting policy (BC 37) is appropriate. The IASB should recognise that the application of the draft standard will result in changes to accounting policies (most probably in the impairment testing area, and in accounting for development activities under other IFRS) during the agreed ‘quiet period’ and should acknowledge that in their documentation. We believe that given the late introduction of the Standard, it would be appropriate to exempt entities from re-stating their comparative information (as required by IFRS 1) for any resulting changes in accounting policy. Such treatment would be consistent with the approach taken to the implementation of IAS 39.

#### Acquired assets

We believe the draft standard should clarify the appropriate accounting treatment where exploration and evaluation costs are acquired as part of a business combination. We believe that the draft standard should clarify that these amounts ought to be treated in a manner consistent with the required treatment for acquired in-process research and development in accordance with IFRS 3 and IAS 38. Some entities currently effectively immediately expense all exploration and evaluation assets, including those acquired directly or through a business combination, whilst others capitalise these assets but expense all other exploration and evaluation expenditure.

Mandating that acquired exploration and evaluation assets should be recognised as an asset based on the “probable” criterion would provide consistency between entities in the extractive industries and provide some consistency with the treatment for research and development. We believe clarifying this point will ensure that assets are separately recognised when appropriate and not simply subsumed into goodwill recognised as a result of the business combination.