Extractives industry- IFRS 6

ICPAK IFRS Week

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Contents - IFRS 6

Introduction

- In December 2004, IASB issued IFRS 6 Exploration for and Evaluation of Mineral Resources to be applied by all entities engaged in exploration and evaluation of mineral resources.

- Until the publication of IFRS 6, IFRSs did not address the accounting for costs incurred in the exploration for and evaluation of mineral resources.

Key Terms

- Exploration and evaluation assets – expenditure recognized as assets in accordance with entity’s accounting policy

Introduction

Key Terms

- Exploration and evaluation expenditure- expenditure in connection with exploration for and evaluation of mineral resources before technical feasibility and commercial viability of extracting a mineral resource are demonstrated

- Exploration for and evaluation of mineral resources- The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resources.

Scope

- The scope of IFRS 6 Exploration for and Evaluation of Mineral Resources is limited to the recognition, measurement and disclosure of expenditure incurred in the phase covering the E&E of mineral resources.

- Although the term used is 'mineral resources', the definitions in IFRS 6 clarify that this extends to cover minerals, oil, natural gas and other similar non-regenerative resources meaning that it applies across the extractives industry sector

  – The limitation of scope to cover the exploration and evaluation phase means that IFRS 6 does not apply to expenditure incurred:

    ➢ In the previous prospecting phase
    ➢ In all phases after the E&E phase has been completed, including development, production, closure and rehabilitation.

IFRS 6 was issued in December 2004 and applies to annual periods beginning on or after 1 January 2006.

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Scope

Pre-exploration activities	Exploration & Evaluation activities	Development activities
Expenditure outside scope of IFRS 6	Expenditure within the scope of IFRS 6	Expenditure outside scope of IFRS 6

Scope- Other standards

IFRS 6 provides partial or complete exemptions from application of certain other IFRSs as follows:

- IAS 16 does not apply to recognition and measurement of E&E assets but applies to PPE used to develop or maintain E&E assets. The presentation requirements of IAS 16 however applies to E&E assets that are also tangible assets.
- IAS 38 does not apply to recognition and measurement of E&E assets. The presentation requirements of IAS 38 however applies to E&E assets that are also intangible assets.

Key aspects of IFRS 6

- IFRS 6 allows entities adopting the standard for the first time to use accounting policies for exploration and evaluation assets that were applied before adopting IFRSs.
- It also modifies impairment testing of exploration and evaluation assets from IAS 36 by introducing different impairment indicators and allowing the carrying amount to be tested at an aggregate level (not greater than a segment).
- Permits a choice of whether an entity expenses all E&E expenditure as incurred, or capitalizes that expenditure (in which case there is a choice about how much of that expenditure might be capitalized) [temporary exemption from IAS 8.11-12- i.e. consider similar assets & conceptual framework to develop accounting policies]
- Contains certain exemptions from the requirements of IAS 36 Impairment of Assets, for the purposes of assessing whether E&E expenditure which has been capitalized is impaired.

Key aspects of IFRS 6

- E&E expenditure does not include costs incurred prior to acquisition of an exploration license.
- Capitalised E&E expenditure must be segregated and accounted for as tangible or intangible assets according to their nature.
- The test for recoverability of E&E assets can combine several CGUs so long as the group is not larger than a segment.

E&E assets

- IFRS 6 provides for examples of E&E expenditure that may be included in initial measurement of exploration and evaluation assets:
    - Acquisition rights to explore (e.g. exploration license)
    - Topographical, geological, geochemical and geophysical studies
    - Exploratory drilling
    - Trenching
    - Sampling
    - Activities in relation to the technical feasibility and commercial viability of extracting mineral resources.

IFRS 6 – Recognition and Measurement of Exploration and Evaluation Assets

Recognition:

- Exploration and evaluation assets shall be measured initially at cost. (The expenditure could include acquisition rights, geological studies, exploratory drilling, trenching, sampling etc.)
- Companies use a variety of methods to account for exploration and evaluation activities, from expensing all related costs to fully capitalizing them
- Therefore, exploration and evaluation assets are defined in terms of the policy each company chooses

Administrative and general overhead costs

- IFRS 6 allows entities to adopt an accounting policy of either expensing or capitalizing admin costs in the initial measurement of an E&E asset.

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IFRS 6 - Recognition and Measurement of Exploration and Evaluation Assets

- Exploration and evaluation assets are recognized at cost
- Examples of costs that may be capitalized:
  - Cost of exploration rights, geological studies, exploratory drilling and sampling, and evaluating technical and commercial viability of extraction

Borrowing costs:

IFRS 6 does not address borrowing costs, in our view, borrowing costs are not E&E expenditure that may be capitalized as E&E assets in accordance with an accounting policy, instead the guidance in IAS 23 should be followed.

Subsequent Measurement

- Exploration and evaluation assets shall be measured initially at cost.
- After initial recognition, an entity shall apply either the cost model or the revaluation model to the exploration and evaluation assets. If the revaluation model is applied (either the model in IAS 16 Property, Plant and Equipment or the model in IAS 38) it shall be consistent with the classification of the assets

Impairment

- The exploration and evaluation assets are tested for impairment when facts and circumstances suggest that the carrying amounts may not be recovered. The assets are also tested for impairment before reclassification out of exploration and evaluation.

- The impairment is measured, presented and disclosed according to IAS 36, ‘Impairment of assets’, except that exploration and evaluation assets are allocated to cash-generating units or groups of cash-generating units no larger than a segment.

Consider the following:

– The period for which entity has the right to explore expires and is not expected to be renewed

– no other substantial expenditures are planned for exploration or evaluation

– the entity decides to stop exploration and evaluation activities because viable quantities have not been found in the area

– although development is likely, the costs capitalized as exploration and evaluation assets exceed the amounts that are likely to be recovered

Impairment losses are taken to profit or loss –in accordance with IAS 36

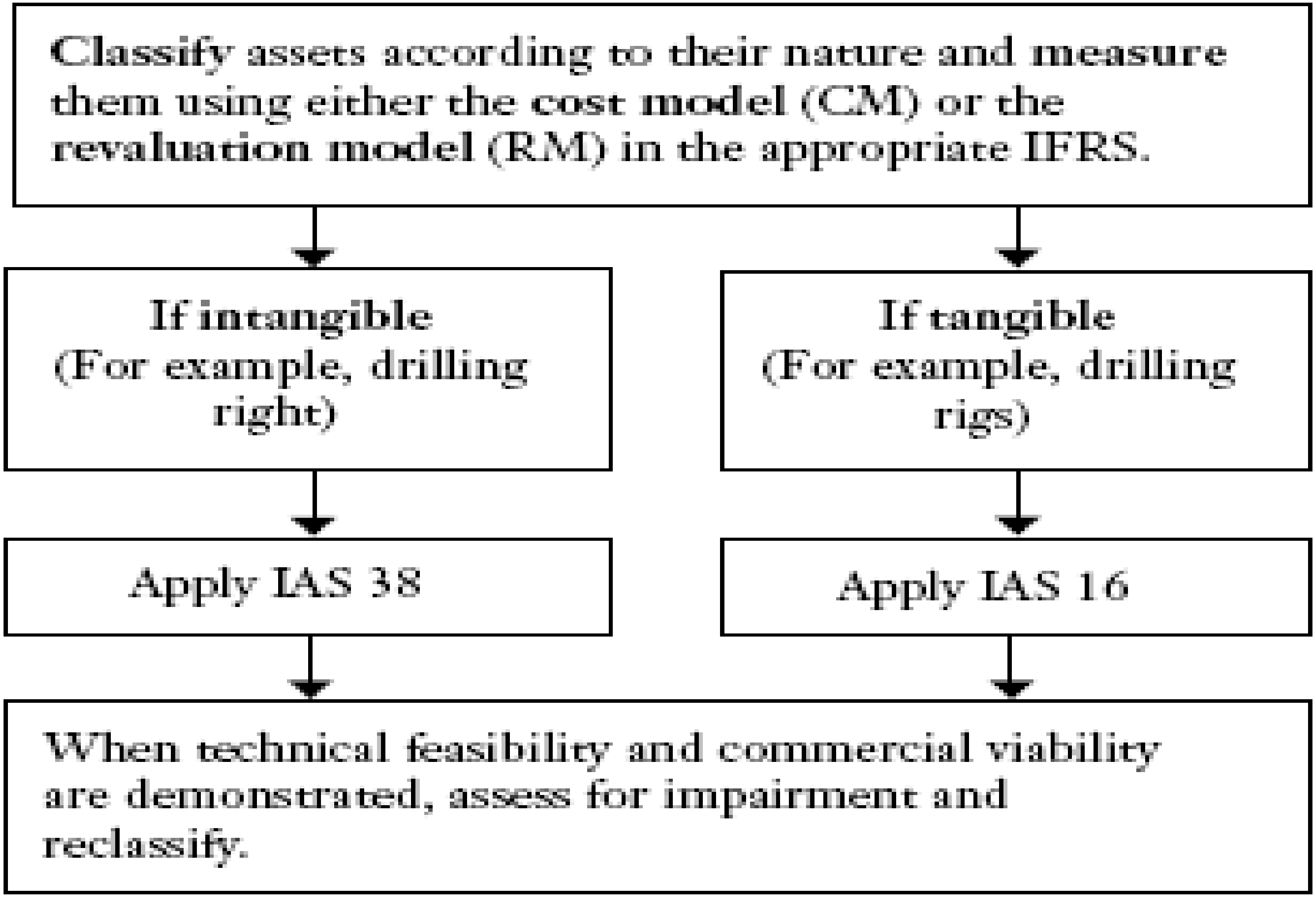
Presentation and classification

- Classification of exploration and evaluation assets

  – An entity shall classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired and apply the classification consistently.

- Some exploration and evaluation assets are treated as intangible (e.g. drilling rights), whereas others are tangible (e.g. vehicles and drilling rigs). To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset.
- However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.

Presentation and classification



Disclosure

- IFRS 6 has an overriding disclosure requirement to include information in the financial statements that identifies and explains the amounts that have been recognized as exploration and evaluation assets. Such information should include the entity's accounting policy for the recognition and measurement of exploration and evaluation assets.
- An entity is also required to identify the amount of assets, liabilities, income and expense arising from the exploration and evaluation of mineral resources. In relation to the statement of cash flows the amount of operating and investing cash flows arising from the exploration and evaluation of mineral resources should be disclosed
- Disclosure objective: to identify and explain amounts recognized in the financial statements that result from exploration and evaluation activities
- If classified as PP&E, use IAS 16
- If classified as intangible asset, use IAS 38

IFRS 6 - Disclosure

- Minimum disclosure:
  - Accounting policies for exploration and evaluation expenditures and their capitalization as assets
  - The amount of assets, liabilities, income, expense, and operating and investing cash flows from exploration and evaluation activities

Q&A

Thank you

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