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IFRS 6 Exploration for and Evaluation of Mineral Resources

The International Accounting Standards Board (IASB) issued International Financial Reporting Standard (IFRS) 6 **Exploration for and Evaluation of Mineral Resources** on 9 December 2004. The Standard, which is effective from 1 January 2006 (with earlier application encouraged), applies to expenditures incurred by an entity in connection with the search for mineral resources.

IFRS 6:

- permits entities to continue to use their existing accounting policies for exploration and evaluation assets, provided that such policies result in information that is relevant and reliable; and
- requires entities to assess any exploration and evaluation assets for impairment when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount. The recognition of impairment in respect of such assets is varied from that in IAS 36 **Impairment of Assets** but, once an impairment has been identified, it is measured in accordance with IAS 36.

Accounting for extractive activities has been identified by the IASB as the topic for a future Standard – although no fixed timetable for the project has yet been set. In the absence of a Standard dealing specifically with this topic, there had been widespread concern that entities engaged in extractive activities and adopting IFRSs for the first time in 2005 would encounter difficulties and uncertainty in determining which accounting policies were acceptable using the criteria set out in IAS 8 **Accounting Policies, Changes in Accounting Estimates and Errors**. Any accounting policies arrived at using those criteria would also be subject to further major changes once the Board had finalised its comprehensive Standard on this topic. Therefore, the principal objective of IFRS 6 is to limit the need for entities to change their existing accounting policies for exploration and evaluation assets.

Scope

IFRS 6 applies to exploration and evaluation expenditures, i.e. to expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources (including minerals, oil, natural gas and similar non-regenerative resources). Affected activities include the search for mineral resources, as well as the determination of the technical feasibility and commercial viability of extracting those resources.

The following are specifically excluded from the scope of IFRS 6:

- expenditures incurred before the entity has obtained legal rights to explore in a specific area; and
- expenditures incurred after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

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Selection of accounting policies for exploration and evaluation assets

A wide variety of accounting policies are followed by entities engaged in the exploration for and evaluation of mineral resources – ranging from deferring on the balance sheet nearly all exploration and evaluation expenditures, to recognising all such expenditures in profit or loss as incurred. IFRS 6 does not require or prohibit any specific accounting policies for the recognition and measurement of exploration and evaluation assets. Rather, it permits entities to continue to use their existing accounting policies provided that they comply with the requirements of paragraph 10 of IAS 8 – i.e. that they result in information that is relevant to the economic decision-making needs of users, and that is reliable.

Paragraphs 11 and 12 of IAS 8 specify the various sources of authoritative requirements and guidance that should generally be considered in developing an accounting policy for an item if no IFRS specifically applies. There had been concern that requiring entities to apply those paragraphs when assessing their existing accounting policies for exploration and evaluation assets would highlight areas of uncertainty. To avoid the potential costs and disruption that such uncertainties could cause, IFRS 6 grants a temporary exemption from applying paragraphs 11 and 12 of IAS 8 until the Board addresses these issues as part of a comprehensive project.

"IFRS 6 does not require or prohibit any specific accounting policies for the recognition and measurement of exploration and evaluation assets."

Changes in accounting policies

Entities may change their accounting policies for exploration and evaluation expenditures if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs, judged using the criteria in IAS 8.

IFRS 6 specifically states that, in order to justify a change in accounting policy for exploration and evaluation expenditures, the entity is required to demonstrate that the change brings its financial statements closer to meeting the criteria in IAS 8. However, the change need not achieve full compliance with those criteria.

Assets to be measured at cost at recognition

When they are first recognised in the balance sheet, exploration and evaluation assets are required to be measured at cost. The expenditures to be included in the cost of such assets are determined by the entity as a matter of accounting policy, which should be applied consistently. In making this determination, the entity should consider the degree to which the expenditures can be associated with finding specific mineral resources.

IFRS 6 lists the following as examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive): acquisition of rights to explore; topographical, geological, geochemical and geophysical studies; exploratory drilling; trenching; sampling; and activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

Where an entity incurs obligations for removal and restoration as a consequence of having undertaken the exploration for and evaluation of mineral resources, those obligations are recognised in accordance with the requirements of IAS 37 **Provisions, Contingent Liabilities and Contingent Assets.**

Subsequent measurement

After recognition, entities can apply either the cost model or the revaluation model to exploration and evaluation assets. Where the revaluation model is selected, the rules of IAS 16 **Property, Plant and Equipment** are applied to exploration and evaluation assets classified as tangible assets, and the rules of IAS 38 **Intangible Assets** are applied to those classified as intangible assets.

"…IFRS 6 modifies the rules of IAS 36 as regards the circumstances in which such assets are required to be assessed for impairment."

Impairment

Because of the difficulty in obtaining the information necessary to estimate future cash flows from exploration and evaluation assets, IFRS 6 modifies the rules of IAS 36 as regards the circumstances in which such assets are required to be assessed for impairment. A detailed impairment test is required in two circumstances:

- when the technical feasibility and commercial viability of extracting a mineral resource become demonstrable, at which point the asset falls outside the scope of IFRS 6 and is reclassified in the financial statements; and
- when facts and circumstances suggest that the asset's carrying amount may exceed its recoverable amount.

IFRS 6 includes the following examples of "facts and circumstances" that may indicate that impairment testing is required (the list is not exhaustive):

- the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;
- exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources, and the entity has decided to discontinue such activities in the specific area; and
- sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

"IFRS 6 allows a greater degree of flexibility as regards the level at which the impairment assessment should be performed."

When such circumstances, or similar circumstances, arise, the entity is required to assess the affected assets for impairment in accordance with IAS 36, subject to special requirements with respect to the level at which impairment is assessed. IFRS 6 allows a greater degree of flexibility as regards the level at which the impairment assessment should be performed. The allocation of exploration and evaluation assets to cash-generating units (CGUs), or groups of units, for the purpose of assessing such assets for impairment can be determined as a matter of accounting policy by individual entities. The only limitation specified is that each CGU, or group of units, to which an exploration and evaluation asset is allocated for this purpose should not be larger than a segment based on either the entity's primary or secondary reporting format under IAS 14 **Segment Reporting**.

Subject to the special requirements set out in the previous paragraph as regards the level at which impairment is assessed, when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset exceeds its recoverable amount, entities should measure, present and disclose any resulting impairment loss in accordance with IAS 36.

Presentation

Entities are required to classify exploration and evaluation assets as tangible or intangible, according to the nature of the assets. Examples of assets to be classified as tangible assets are vehicles and drilling rigs. Intangible assets will include items such as drilling rights.

Once the technical feasibility and commercial viability of extracting a mineral resource becomes demonstrable, any previously recognised exploration and evaluation asset falls outside the scope of IFRS 6 and is reclassified in accordance with other relevant Standards. The assets should be assessed for impairment, and any impairment loss recognised, before reclassification.

Disclosure

Entities are required to disclose information that identifies and explains the amounts recognised in their financial statements arising from the exploration for and evaluation of mineral resources. To comply with this requirement, the following should be disclosed:

- the entity's accounting policies for exploration and evaluation expenditures, including the recognition of exploration and evaluation assets; and
- the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.

"Exploration and evaluation assets will be treated as a separate class of assets for disclosure purposes."

Exploration and evaluation assets will be treated as a separate class of assets for disclosure purposes. The disclosures required by either IAS 16 or IAS 38 should be made, consistent with how the assets are classified.

Effective date and transitional provisions

IFRS 6 is effective for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies IFRS 6 for a period beginning before 1 January 2006, that fact should be disclosed. For entities that chose to wait until 1 January 2006 to adopt the Standard, IAS 8 requires the entity to disclose that fact and, if estimable, the expected impact in the period of initial application.

"…it is likely that the vast majority of affected entities applying IFRSs in 2005 will select the alternative of early adoption."

The IASB has delayed the implementation date for IFRS 6 to 1 January 2006 in order not to disturb the 'stable platform' for 2005 and to allow more time to make the transition to the IFRS. However, given that the principal objective of IFRS 6 is to provide relief from applying the more rigorous requirements of IAS 8, it is likely that the vast majority of affected entities applying IFRSs in 2005 will select the alternative of early adoption.

The adoption of IFRS 6 will not generally result in changes in accounting policies for the recognition and measurement of exploration and evaluation assets. Where an entity voluntarily changes its accounting policies to improve the relevance or reliability of the financial information provided in respect of such assets, then the general principles of IAS 8 apply. Therefore, such changes in accounting policies should be applied retrospectively, unless it is impracticable to do so.

As regards impairment testing, the general requirement on the adoption of IFRS 6 is that entities recognising exploration and evaluation assets should determine whether there were any facts and circumstances indicating impairment in prior periods. Any identified impairment should generally be recognised retrospectively. However, the Board has permitted an exemption where it is impracticable to apply the impairment rules to comparative information that relates to an annual period beginning before 1 January 2006. The rules need not be applied retrospectively in such circumstances, provided that the entity discloses that fact.

First time adoption

IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been amended for entities adopting IFRSs for the first time before 1 January 2006 and choosing to adopt IFRS 6 before 1 January 2006. Such entities need not present the disclosures required by IFRS 6 for comparative periods in their first IFRS financial statements. This exemption is not available for entities adopting IFRSs for the first time on or after 1 January 2006.

Otherwise, the requirements of IFRS 6 should be applied retrospectively by first-time adopters. Note that the exemption as regards recognition of impairment for comparative periods beginning before 1 January 2006 outlined in the previous section does not apply to first-time adopters. Therefore, for example, entities adopting IFRSs for the first time from 1 January 2005, and electing to adopt IFRS 6 before its effective date, should apply the impairment requirements of IFRS 6 retrospectively at the date of transition.

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