

**REGULATION IMPACT
STATEMENT**

AASB 6
December 2004

Exploration for and Evaluation of Mineral Resources



Australian Government

**Australian Accounting
Standards Board**

Regulation Impact Statement

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Background

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's (FRC) strategic directives to adopt International Financial Reporting Standards [the Standards and Interpretations of the International Accounting Standards Board (IASB)] for application to reporting periods beginning on or after 1 January 2005 and to harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics. To put the first of the FRC directives into effect the AASB is issuing Australian equivalents to IASB Standards and has undertaken a separate project in respect of harmonising financial reporting requirements and Government Finance Statistics. Implementation of the FRC's Year 2005 strategic directive does not, of itself, cause a change in the underlying economic circumstances of an entity but at times results in events and transactions being portrayed differently so as to achieve improvements in the transparency and quality of Australian financial reports.

The AASB has decided to continue to issue one series of sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. The AASB has regard to the Standards of the International Public Sector Accounting Standards Board (IPSASB) in respect of issues affecting not-for-profit entities. The IPSASB is using the IASB's Standards, to the extent possible, as the basis for International Public Sector Accounting Standard (IPSAS). Accordingly, adopting IASB Standards simultaneously helps convergence with existing and future IPSASs. Except for Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, broadening the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues. The AASB also retains guidance from superseded AASB Standards in an Appendix to the new Standards where it considers that guidance to be important to facilitate implementation and compliance with a Standard. In addition, in respect of optional treatments included in IASB Standards, the AASB decided it would generally require only one treatment in order to facilitate comparability of financial reports in Australia.

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB are to:

- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- make accounting standards under section 334 of the *Corporations Act 2001* for the purposes of the corporations legislation;
- formulate accounting standards for other purposes; and
- participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

Functions of the FRC include determining the AASB's broad strategic direction, monitoring the development of international standards and the accounting standards that apply in major international financial centres, to further the development of a single set of standards for world-wide use with appropriate regard to international developments and to promote the adoption of international best practice in the Australian accounting standard-setting process.

Both the AASB and the FRC are required to advance the main objects of Part 12 of the ASIC Act, Section 224, to:

- facilitate the development of accounting standards that require the provision of financial information that allows users to make and evaluate decisions about allocating scarce resources, assists directors to discharge their obligations in relation to financial reporting, is relevant to assessing performance, financial position, financing and investment, is relevant and reliable, facilitates comparability and is readily understandable;
- facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas and having accounting standards that are clearly stated and easy to understand; and
- maintain investor confidence in the Australian economy (including its capital markets).

It is in this context that the FRC has decided to direct the AASB to:

- adopt IASB Standards with effect from 1 January 2005; and

- harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics.

In accordance with the FRC's strategic direction, the AASB made, as accounting standards, Australian equivalents to the existing set of IASB Standards on 15 July 2004. AASB 6 *Exploration for and Evaluation of Mineral Resources* will also form part of the set of Australian equivalents to IASB Standards, and is the Australian equivalent of IFRS 6 *Exploration for and Evaluation of Mineral Resources*, which will be released by the IASB in December 2004.

1. Problem

Failure by the AASB to adopt IFRS 6 would be inconsistent with the FRC's directive on IASB Standards.

The treatment of exploration and evaluation costs under Accounting Standard AASB 1022 and Australian Accounting Standard AAS 7 *Accounting for the Extractive Industries* is consistent with the treatments permitted by IFRS 6 *Exploration for and Evaluation of Mineral Resources*, which provides entities with the discretion to determine the treatment of their exploration and evaluation costs. However adopting IFRS 6 without amendment would adversely affect comparability between Australian reporting entities as they would have a wider range of accounting choices than currently permitted by AASB 1022/AAS 7.

In addition, AASB 1022/AAS 7 have a broader scope than IFRS 6. AASB 1022/AAS 7 also deal with costs incurred in other phases of extractive activity operations as well as the treatment of inventories and sales revenue. In contrast, these other matters are dealt with in other IASB Standards, sometimes differently from AASB 1022/AAS 7.

2. Objectives

The AASB's objectives in addressing the problem are to improve the quality and usefulness of financial reporting in Australia in respect of both for-profit and not-for-profit reporting entities in the private and public sectors and to implement the FRC's directives.

3. Options

Option 1

Adopt IFRS 6 without amendment.

Option 2¹

Adopt IFRS 6 and include additional Australian requirements to facilitate greater comparability for Australian reporting entities.

Option 3

Not adopt IFRS 6 and retain AASB 1022/AAS 7 (unamended).

Option 4

Revise AASB 1022/AAS 7 so that they are IASB compliant.

4 Impact Analysis

4.1 Affected Parties

Parties likely to be most directly affected by the proposed Standard are:

- (a) reporting entities required to prepare general purpose financial reports and that are engaged in exploring for mineral resources;
- (b) users of reports identified in (a) such as:
 - (i) resource providers (including fund managers, investors, creditors and employees);
 - (ii) recipients of goods and services;
 - (iii) parties performing a review or oversight function (including ASIC and ASX); and
 - (iv) management and governing bodies (including use of these reports in the discharge of accountability).

Parties likely to be indirectly or less directly affected by the proposed Standard include:

- (a) participants in the Australian capital markets; and
- (b) the wider community affected by the efficiency of the Australian capital markets and their reputation inside Australia and overseas.

¹ Option 2 is based on the additional Australian requirements being included in the Australian equivalent to IFRS 6. Alternatively, Option 2 could involve retaining AASB 1022/AAS 7 as Accounting Standards, but amending their content so that they only deal with the treatment of exploration and evaluation costs. Including the additional requirements in an Australian equivalent to IFRS 6 was favoured for simplicity and to avoid users mistakenly believing that AASB 1022/AAS 7 have been retained unamended.

4.2 *Effect on Existing Regulations*

Specifically, the primary impact of adopting IFRS 6, and the consequential withdrawal of AASB 1022/AAS 7, is that Australian reporting entities will not have an industry-specific Standard that addresses other aspects of extractive activity accounting such as the:

- treatment of development, construction and restoration costs;
- amortisation of those costs;
- treatment of inventories; and
- revenue recognition.

Instead, Australian reporting entities will be required to apply other Australian equivalents to IASB Standards to determine the treatment of these other aspects.

4.3 *Costs and benefits*

When issuing Exposure Drafts of Australian equivalents of IASB Standards, the AASB specifically sought comment from constituents on whether the proposals are in the best interests of the Australian economy and on whether there are regulatory or other issues that may affect the implementation of the proposals. The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial reports. The costs of providing financial information are incurred, in the main, by reporting entities, but extend in various direct and indirect ways to the users of general purpose financial reports. There is no guarantee that the costs are borne ultimately by those who derive the benefits. The AASB considers the benefits and costs for individual Standards in the context of the Year 2005 strategic directive as a whole.

IFRS 6 provides entities with the discretion to determine the treatment of their exploration and evaluation costs (that is, whether those costs should be capitalised or expensed). Therefore, the adoption of IFRS 6 should have a negligible effect on accounting for exploration and evaluation costs by preparers of financial reports – including entities engaged primarily in the exploration for mineral resources (“junior explorers”). In limited circumstances, IFRS 6 may require an entity to perform a more rigorous impairment test of their exploration and evaluation costs than previously required by AASB 1022/AAS 7. The added preparation costs that may be imposed by this requirement will however be offset by the IFRS 6 impairment test promoting greater international comparability in the

treatment of exploration and evaluation costs. In those limited circumstances where the IFRS 6 impairment test is applied and some or all of the capitalised exploration and evaluation costs must be written off, the entity's net asset position will be reduced. This change is not expected to disadvantage the interpretation of the entity's key financial indicators or significantly affect the entity's ability to attract equity finance because users of financial reports (and in particular, equity providers) also use other disclosed information to assess the performance of the entity, for example, cashflow information, such as that required to be disclosed by ASX Listing Rules 4.7B and 5.3A.

Options 1 and 2 enable compliance with the FRC directive. The impact of adopting Option 1 is that IFRS 6 allows entities to determine an accounting policy for the treatment of their exploration and evaluation costs, including determining the level at which exploration and evaluation costs would be capitalised. Accordingly, an entity could adopt a "full cost" accounting approach whereby, for instance, all of its worldwide exploration and evaluation costs could be capitalised (impairment testing requirements permitting). Full cost accounting is not permitted under AASB 1022/AAS 7, and consequently the added choice of accounting policies permitted by IFRS 6 may adversely affect the comparability of the financial reports of Australian reporting entities engaged in exploration and evaluation activities. In contrast, Option 2 would ensure that an entity's accounting policies for exploration and evaluation costs remain consistent with the "area of interest" approach prescribed by AASB 1022/AAS 7, thereby retaining the existing level of comparability between Australian reporting entities. Option 3 would mean that there would not be an Australian Standard equivalent to IFRS 6 and this would be inconsistent with the FRC's policy directive relating to adoption of IASB Standards thus excluding Australian entities from the benefits flowing from the FRC's policy directive. While it may be possible under Option 4 to amend existing Australian Accounting Standards so that they are IASB compliant, this would be an extremely complex approach, potentially confusing to users and IASB compliance could be subject to challenge. To reduce the risk that the requirements of a revised AASB 1022/AAS 7 would be considered to be inconsistent with IASB Standards, the scope of the revised Standard may have to be restricted to the treatment of exploration and evaluation costs, in which case the practical effect of Option 4 would be likely to be equivalent to Option 2.

5. Consultation

The AASB issued Exposure Draft ED 130 *Request for Comment on IASB ED 6 Exploration for and Evaluation of Mineral Resources* in January 2004 as part of the AASB's due process in implementing the FRC's directives. When issuing ED 130 the AASB requested comment on:

- the impact that a more rigorous impairment regime (as proposed in the Exposure Draft) may have on the ability of Australian entities to capitalise their exploration and evaluation costs;
- whether the proposed adoption of the proposed IASB Standard is appropriate and workable; and
- whether the proposals are in the best interests of the Australian economy.

Fourteen submissions were received in respect of the proposals in ED 130 and there was substantial concern expressed about the potential effects of adopting an Australian equivalent to the IASB Standard reflecting the proposals in IASB ED 6. The primary concern, which was shared by the AASB, related to the potential impact of the proposals in respect of the impairment testing requirements on small and medium exploration entities which form a significant part of the mineral exploration activities in Australia. The impairment testing requirement, as reflected in IASB ED 6, would require most of these entities to expense all of their exploration and evaluation costs whereas under AASB 1022/AAS 7 they may have been able to capitalise those costs. As a result, these proposals were considered to be inconsistent with the IASB's intention for IASB ED 6, essentially being to "grandfather" existing treatments of exploration and evaluation costs pending the completion of a comprehensive project on extractive activity accounting. The AASB, as well as Australian reporting entities involved in extractive activities and others, raised these concerns with the IASB in their IASB ED 6 comments and in responding to a subsequent request for comment on the impairment testing requirement. The IASB took those comments into account in finalising IFRS 6 and the amended impairment testing requirement should, in most cases, allow Australian reporting entities to treat their exploration and evaluation costs in the same manner as under AASB 1022/AAS 7. The amended impairment testing requirement is reflected in IFRS 6, and therefore in the Australian equivalent to IFRS 6.

6. Conclusion and Recommendation

In complying with the FRC directive in relation to IASB Standards the AASB decided to follow Option 2 and adopt IFRS 6 by making an Australian equivalent to IFRS 6 that includes additional Australian requirements.

In making its decision to adopt IFRS 6, the AASB considered that, on balance, the benefits of facilitating the Australian economy by reducing the cost of capital, enabling entities to compete effectively overseas and the provision of information that is relevant, reliable and facilitates comparability outweighed the costs to individual entities of adopting Australian equivalents to IASB Standards.

The AASB favoured Option 2 over Option 1 (being to adopt IFRS 6 without amendment) on the basis that making an Australian equivalent to IFRS 6 that includes additional Australian requirements is considered to facilitate greater comparability between Australian reporting entities. IFRS 6 provides entities with the discretion to determine the treatment of their exploration and evaluation costs. By adopting IFRS 6 with the inclusion of additional paragraphs that require the treatment of exploration and evaluation costs to be consistent with the “area of interest” approach prescribed by AASB 1022/AAS 7, the AASB has retained the existing level of comparability between Australian reporting entities engaged in exploration and evaluation activities.

7. Implementation and Review

AASB 6 *Exploration for and Evaluation of Mineral Resources* (which will be the Australian equivalent to IFRS 6) will be subject to review and revision taking account of international developments, particularly the processes for review and revision undertaken by the IASB, and of the experience of constituents in implementing the Standard.