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N°249

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Sir DAVID TWEEDIE
IASB Chairman
30 Cannon Street

LONDON EC4M 6XH

United Kingdom

Dear David,

On behalf of the Conseil National de la Comptabilité (CNC) I am writing to comment on the Exposure Draft ED6 "*Exploration for and Evaluation of Mineral Resources.*" The CNC has set up a working group of preparers and auditors on the proposed Exposure Draft. The first analysis of the group is that the IAS standard is complex to analyze, and its consequences difficult to grasp because it covers some sectors of activities with different current accounting policies.

We have identified the following main areas of concern:

- scope: we suggest to separate oil/ gas activities from other extractive activities. For oil and gas activities existing practice and accounting policies applied by the major companies are well stabilised notably through US standards and financial statements are comparable. For other extractive activities, the practice is more divergent and accounting policies may differ for each company.

- at this stage, as the standard is a provisional one, we consider that the definitive standard should cover exploration, development and production phases. Some questions remain to be considered, for example: farm in/farm out transactions, over/under lifting, tax treatment as well as uplifts and relevant investments tax credit, unitisation arrangements, gas banking, carried interests agreement, reserves issues related to depreciation and impairment calculations, used for accounting purposes.

- the conceptual method used for exploration and evaluation assets should be clearly stated and applied for recognition, measurement and impairment: if the standard intends to refer to the full cost method, we consider essential that the successful efforts method be also adopted as it is the one mainly applied by all the major companies.

- lastly, we are strongly opposed to any reference to the concept of a special cash generating unit for exploration and evaluation. We believe that the IAS 36 impairment test is inappropriate and not relevant to an environment which structurally does not generate any cash and should not be applied to this activity. In order to achieve limited improvements to accounting practices for evaluation and exploration expenditures, we encourage the Board to converge with the American standard FAS 19 widely implemented in the oil and gas industry.

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 agree with the proposed definitions.
Nevertheless, considering the terms "may be included" may lead to an understanding that a company could choose to include these costs in the initial measurement of exploration and evaluation assets or consider them as expenditures. This approach is not consistent with the successful efforts method widely used for exploration and evaluation expenditures. For example, the successful efforts method requires prospecting costs such as topographical, geological and geophysical studies to be expensed.
Considering § 7 b and 7 f, we suggest to the Board that they should give some examples and we suggest to refer to the IAS 16 § 16b and § 17 definition of indirect costs: « *any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management such as:*

-costs of employee benefits arising directly from the construction or acquisition of the item property, plant and equipment ;
-costs of site preparation
-initial delivery and handling costs
-installation and assembly costs
-costs of testing whether the asset is functioning properly
-professional fees. »

The current practice is to allocate to the operations, as directly as possible, the related costs in order to measure their real costs.
We agree to exclude the other Administration and General overhead costs not related to exploration and evaluation activity.

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 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-BC11 of the Basis for Conclusions).
Are these proposals appropriate? If not, why not?

We consider that the ED 6 proposal to continue to use the existing policies must cover not only the recognition and measurement but also depreciation and impairment of exploration and evaluation expenditures. Even if options are at this stage available, the careful reading of the draft leads to believe that the conceptual guiding principle refers to the "full costs method". Under this method all costs are capitalised when incurred. We consider that this method does not account for the economics of activities linked to the discovery of reserves (in gas and oil activities, for example). The "successful efforts method" where costs are capitalised when reserves are discovered, should be recommended.

Question 3 – Cash-generating units for exploration and evaluation assets
[Draft] IAS 36[1] 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 proposed 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?

1 in Exposure Draft of *Proposed Amendments to IAS 36*, *Impairment of Assets*, *and IAS 38*, *Intangible Assets* (December 2002)

Although we agree with periodical assessments of exploration and evaluation assets, we disagree with the method proposed by the Board:

- the concept of cash generating unit is not appropriate for exploration and evaluation assets. It would be very difficult to implement CGU for exploration activities that do not generate cash flows.
- the definition of a CGU is not very clear: project, field, permit or license, country, geographical area? In some cases, a wide CGU would lead not to depreciate assets that will never be developed or located within areas of the CGU where no reserves have been discovered.
- financial statements would not be enhanced because CGU concept would not reflect the real risks and rewards linked to a project.

When using the successful efforts method for exploration and evaluation activities which we recommended, the IAS 36 impairment test could not be applied.
We suggest the Board converge with FAS 19§ 31 to determine which criteria to use to write off assets. For example the drilling cost should continue to be carried as an asset pending determination whether reserves have been found, if the drilling of the well is planned in the near future. In absence of a determination whether the discovery of reserves can be classified as successful, the costs of drilling should be expensed.

We consider that some criteria listed in § 13 of the IAS draft are self sufficient to measure an operation and to allow the recognition of an asset or an expense.

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 (paragraph 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 consider that the proposed indicators are appropriate and could be used to assess the value of exploration assets. As those indicators are most relevant, there is no need to make further depreciation test, which we suggest.

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?

If our proposal of maintaining current accounting practices for recognition, measurement and impairment for exploration assets is retained, companies should disclose information concerning:

- accounting principles adopted (successful efforts or full costs method),
- capitalized costs related to exploration work in progress,
- amount of extractive rights,
- expenses related to exploration incurred in the year,
- exploration commitments

Yours sincerely,

Antoine BRACCHI