Extractive Activities—Project update

Deciding project scope and objectives

In its September 2021 meeting, the International Accounting Standards Board (IASB) made tentative decisions about the scope and objectives of its Extractive Activities project.

The IASB decided to explore:

- developing requirements or guidance to improve the disclosure objectives and requirements in IFRS 6 *Exploration for and Evaluation of Mineral Resources* relating to a company's exploration and evaluation expenditure and activities; and
- removing the temporary status of IFRS 6.

The IASB decided it lacked sufficient evidence to suggest that the benefits of reduced diversity in the accounting policies applied to exploration and evaluation expenditure would outweigh the costs of implementing any changes. The IASB also considered, but decided not to explore developing requirements or guidance for reserve and resource information in financial statements.

In this update, Tadeu Cendon, a member of the IASB, discusses some of the IASB's decisions and the reasons the IASB reached those decisions.

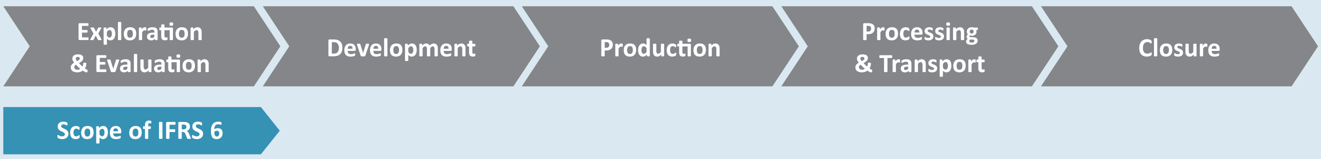
Why are we looking at extractive activities?

When we issued IFRS 6 in 2004, it was intended to be an interim step in the accounting for extractive activities. In 2010, we published the Discussion Paper *Extractive Activities*. The feedback on that paper provided us with inputs for our current project, which we started in 2018, to help us decide whether to amend or replace IFRS 6. We asked for the views of a variety of stakeholders, including users of financial statements (investors), from a variety of jurisdictions, and performed further research to help us to make decisions about the project's scope and objectives.

What are extractive activities?

Extractive activities consist of exploring for, evaluating, developing and producing natural resources such as minerals, oil, natural gas and similar non-regenerative resources. Such activities are particularly significant in some countries.

Diagram 1—Phases of extractive activities



What are extractive activities?

Extractive activities usually fall into distinct phases, with various activities performed in each phase, including:

- *exploration and evaluation*—acquisition of legal rights, exploratory drilling and feasibility studies;
- *development*—development drilling, development of mine sites and construction of facilities;
- *production*—extraction and on-site processing;
- *processing and transport*—processing, treatment, storage and transportation; and
- *closure*—rehabilitating the mine or production site, plugging of wells and removal of infrastructure.

What have we heard?

Stakeholders told us that:

- IFRS 6 has allowed diversity in the accounting policies applied to exploration and evaluation expenditure to continue. Information about those accounting policies is sometimes unclear.
- information about a company's reserves and resources is important for investors and is subject to differing regulatory requirements.
- companies have difficulties applying some IFRS Accounting Standards to extractive activities outside the scope of IFRS 6.

My personal reflections

My initial view, when I heard about the diversity in accounting policies for exploration and evaluation expenditure, was that we should do something about this. However, when I was participating in meetings with investors, there wasn't a clear message from them that this was something we should resolve. Instead, many investors said they would prefer us to improve the disclosure requirements rather than address the diversity in accounting policies.

Although we decided to explore improvements to some disclosures, we decided not to explore developing requirements or guidance for the use and disclosure of reserve and resource information in financial statements because, among other reasons, this information is beyond the remit of the IASB. Although I agreed with this decision, I believe management might still need to disclose information about reserves and resources when these are a material input into calculating, for example, depreciation, impairment and provisions in financial statements.

What did we decide?

Our tentative decision is that the scope and objectives of the Extractive Activities project should be to explore:

- developing requirements or guidance to improve the disclosure objectives and requirements in IFRS 6 relating to a company's exploration and evaluation expenditure and activities, with the objective of providing more useful information; and
- removing the temporary status of IFRS 6.

We also decided not to develop requirements or guidance as part of our Extractive Activities project on other matters such as[1]:

- the unit of account to apply to exploration and evaluation expenditure, which exploration and evaluation expenditures to capitalise and when to start and stop capitalising those expenditures;
- the challenges of applying Accounting Standards other than IFRS 6 to extractive activities and the accounting for collaborative arrangements; and
- the use and disclosure of reserve and resource information in financial statements.

1 IASB Update lists decisions reached by the IASB at its September 2021 meeting.

What does IFRS 6 require?

IFRS 6 was issued as an interim Accounting Standard in 2004, before the IASB completed a comprehensive review of accounting for extractive activities, to help companies that were changing the basis for preparing their financial statements to IFRS Accounting Standards at that time[2].

IFRS 6 focuses only on exploration and evaluation expenditure and does not apply to expenditure incurred:

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

The Accounting Standard provides a company with a temporary exemption from applying some paragraphs of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing its accounting policies. This exemption helped limit the need for companies to change their accounting policies for exploration and evaluation assets when adopting IFRS Accounting Standards.

A company has to decide which expenditures to capitalise as exploration and evaluation assets. The Accounting Standard provides a list, which is not exhaustive, of examples of expenditures that might be included.

The Accounting Standard also contains a list of impairment indicators for exploration and evaluation assets—which, again, is not exhaustive—replacing those in IAS 36 *Impairment of Assets*. If such an indicator is identified, the company tests its exploration and evaluation asset for impairment by applying IAS 36. IFRS 6 requires exploration and evaluation assets to be allocated to cash-generating units or groups of cash-generating units for the purpose of assessing these assets for impairment.

Matters in the scope of IFRS 6

Stakeholders told us that IFRS 6 has allowed companies to continue applying diverse accounting policies to exploration and evaluation expenditure. Recent academic evidence and our own research have confirmed this view. Our research has shown that such diversity mainly arises from companies making contrasting decisions about whether to capitalise exploration and evaluation expenditure, which types of those expenditures they capitalise, when they start and stop capitalising those expenditures, and the unit of account they apply to those expenditures. For example, companies make diverse judgements about whether to aggregate expenditure by oil well, licence area, country and so on. We also found that companies do not always clearly disclose the accounting policy they apply to exploration and evaluation expenditure.

Comparability is one of the qualitative characteristics of useful financial information and some stakeholders suggested we amend IFRS 6 to limit these diverse accounting policies and improve comparability.

Despite evidence of diversity, we did not find evidence of a significant financial reporting problem.

Some of the diversity could reflect company-specific facts and circumstances, and the various ways companies manage their exploration and evaluation expenditure and activities.

The extractives industry has well-established accounting practices that pre-date IFRS 6. Our research identified some industry trends and some evidence of alignment of accounting practices between peers. Changes to IFRS 6 could, therefore, be disruptive.

2 In 2010 the IASB published the Discussion Paper *Extractive Activities* after a research project by staff from the national standard-setters in Australia, Canada, Norway and South Africa.

Many investors told us that information about exploration and evaluation expenditure is very important but, despite this, most indicated that the differences in accounting for exploration and evaluation expenditure is not a very significant concern for them, and they can manage this diversity.

Therefore, we decided that, although there is diversity in accounting policies, the costs of making improvements here would outweigh the benefits.

> … we have moved to a way of thinking and making decisions—about what we work on, what we don't work on and the scope of our work—that is based on evidence that a financial reporting problem needs to be fixed, and we're going to think about the cost–benefit and the prioritisation accordingly.
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> **IASB Member, September 2021 IASB meeting**

Many investors said we should instead improve the disclosures companies make about exploration and evaluation expenditure and activities. This could improve the transparency and comparability of information about exploration and evaluation expenditure and activities. For example, providing information about not only the accounting policy a company chooses but also the reasons for that choice could be useful. This transparency is particularly important not just because of the diversity, but also because of the significant judgements involved.

Therefore, we decided to explore developing requirements or guidance to improve the disclosure objectives and requirements in IFRS 6 relating to exploration and evaluation expenditure and activities, with the objective of providing more useful information.

> … our conclusion is not that the accounting is good and useful and doesn't need improvement … our conclusion is there is diversity in practice in this area of exploration and evaluation costs. Would addressing this diversity improve the usefulness of financial statements? Yes. But our conclusion is that the cost of addressing those areas would not be exceeded by the benefit.
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> **IASB Member, September 2021 IASB meeting**

We also decided to explore removing the temporary status of IFRS 6, which would make permanent the exemption from applying some paragraphs of IAS 8 when developing an accounting policy. Making this change would not mean we think the accounting that results from this exemption—that is, the diversity in accounting policies applied to exploration and evaluation expenditure—is ideal. Rather, our research showed that the industry has developed well understood accounting practices over time and investors can cope with the accounting policy diversity. We do not think the problem is significant enough to justify the costs of making improvements.

Matters arising from applying other IFRS Accounting Standards

Many of our stakeholders identified challenges in applying some Accounting Standards to extractive activities outside the scope of IFRS 6. For example, stakeholders identified challenges in applying IFRS 11 *Joint Arrangements*—joint arrangements are commonly used in the extractives industry. Stakeholders also identified challenges in deciding which Accounting Standards to apply to collaborative agreements.

We decided not to include such matters in this project. We did not identify compelling evidence to suggest that we should address these matters specifically for companies with extractive activities. The matters highlighted would also be relevant to companies in other industries and, therefore, developing requirements or guidance to address them could have wider implications or unintended consequences.

However, many of these matters relate to other projects on our work plan including, for example, the Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*, and the Third Agenda Consultation. We have passed on the relevant feedback to those projects' teams.

Reserve and resource information

Stakeholders told us that investors find information about reserves and resources important, with many investors indicating that they need this information for forecasting and valuation modelling and analyses. Our research indicated that the requirements to disclose reserve and resource information can vary by jurisdiction, and some jurisdictions have no requirements. Where required, reserve and resource information is generally disclosed outside financial statements.

Reserve and resource information can also be an important input in determining financial statement items such as depreciation, impairment losses and decommissioning provisions.

Consequently, many stakeholders suggested that we consider whether IFRS Accounting Standards should require disclosure of reserve and resource information in financial statements.

What are 'reserves' and 'resources'?

Reserves generally refer to the quantity of minerals or oil and gas estimated to be economically recoverable (that is, reserve quantities are an estimate of the aggregate future production of minerals or oil and gas).

Resources generally refer to the quantity of minerals or oil and gas discovered, but not yet capable of being classified as reserves.

Reserves and resources are generally classified into sub-categories, such as proved or probable reserves, according to the amount of confidence associated with the quantity estimates.

Jurisdictions require diverse classification systems for measuring and publicly reporting reserve and resource quantities.

However, two internationally recognised classification systems (one for minerals and one for oil and gas) generally form the basis of disclosure requirements in most jurisdictions that require companies to disclose reserve and resource information.

Reserve and resource information is generally not as relevant to exploration and evaluation activities as it is to extractive activities outside the scope of IFRS 6. Exploration and evaluation activities generally occur before the identification and disclosure of a reserve.

We decided not to develop requirements or guidance for the use and disclosure of reserve and resource information in financial statements.

Reserve and resource information is similar in nature to other information that is important to investors of companies in other industries that is generally not required to be disclosed in financial statements—for example, details of the research pipeline of drugs for a pharmaceutical company. Many stakeholders said providing reserve and resource information is beyond the remit of the IASB and of financial statements.

In most jurisdictions with significant extractive industries, regulators already require the disclosure of reserve and resource information, having concluded this information is important for investors. Most investors indicated they obtain sufficient and relevant reserve and resource information for the majority of companies they follow.

We also have practical reasons for deciding not to explore requirements or guidance for the use and disclosure of reserve and resource information in financial statements. For example, a new set of disclosure requirements could confuse investors. Many jurisdictions' regulators already have disclosure requirements for reserve and resource information; any that we develop might use a different basis, creating confusion.

Stakeholders also said the cost of auditing reserve and resource information in financial statements could be significant.

Therefore, we decided we lacked sufficiently compelling evidence to develop requirements or guidance for the use and disclosure of reserve and resource information in financial statements.

What happens next?

We are considering what research would be needed to identify:

- the information investors need about exploration and evaluation expenditure;
- why they do not currently get that information; and
- the costs of providing that information.

We are also considering the appropriate timing of that research.

To read further information about the project or to receive project updates

Visit the Extractive Activities project page on the IFRS Foundation website.

To get in touch

Contact Tim Craig at tcraig@ifrs.org.

Follow @IFRSFoundation on Twitter to keep up with changes in the world of IFRS Standards.