ACCURATE AND RELIABLE

INSIGHT PAPER · OIL & GAS · IFRS 6

Exploration & Evaluation

Why accounting for E&E expenditure remains one of the least comparable areas of IFRS reporting — and what the IASB is doing about it.

IN THIS PAPER

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SUBJECT

IFRS 6, extractive activities and disclosure

PREPARED FOR

Finance teams and auditors
in extractive industries

ENQUIRIES

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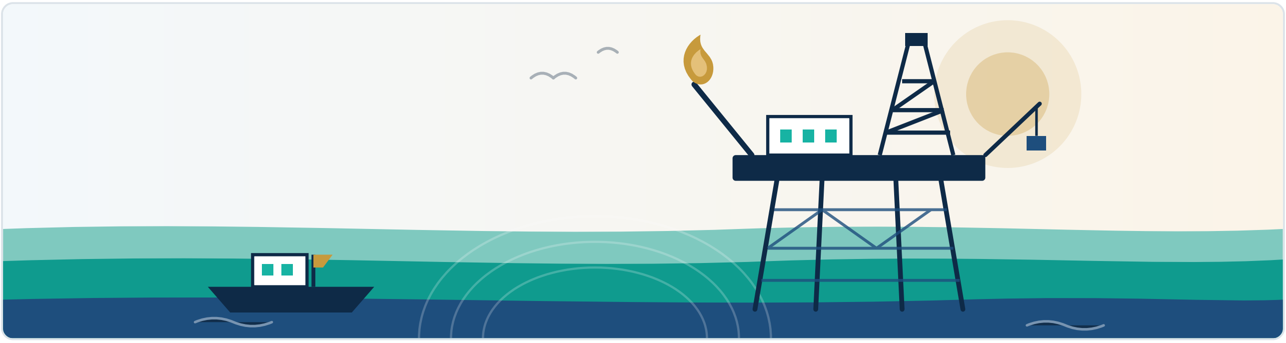
01 — THE PROBLEM

The limits of accounting comparability

Despite the continuous adoption of IFRS, or convergence of national accounting standards with IFRS across the world, there remain concerns and debates about the levels of accounting comparability between companies.

Significant aspects of these concerns relate to the level of assets recognised in financial statements, and the accompanying disclosures as mandated by the standards. Arguably, this is in part because of the **principles-based nature** of some IFRS, the application of which allows for managerial discretion. Exploration & Evaluation expenditure is one of them.



Exploration and evaluation expenditure sits at the point where geological uncertainty meets the recognition criteria for an asset.

02 — DEFINITION

What E&E expenditure covers

Exploration & Evaluation (E&E) expenses include:

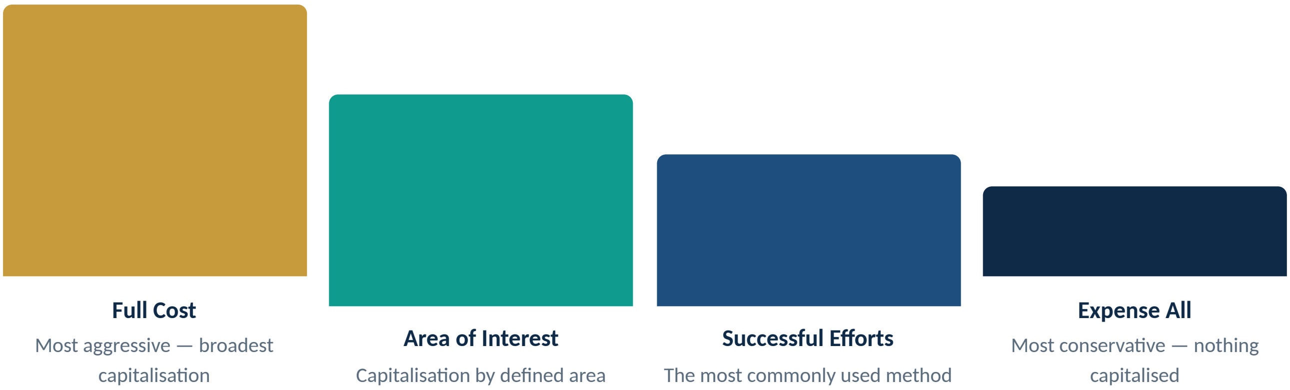
- The acquisition of rights to explore
- Topographical, geological, geochemical and geophysical studies
- Exploratory drilling
- Trenching
- Sampling
- Activities that relate to evaluating the technical feasibility and commercial viability of extracting a mineral resource

> **In essence, the accounting for E&E costs can be viewed as an extension of the debate on the recognition of intangible assets versus the level of accounting conservatism.**

03 — PRACTICE

Four methods, no single requirement

While IFRS 6 makes no specific requirement, there are four prevalent accounting methods that are generally applied to E&E costs. These have been broadly defined and grouped in practice as follows, from most aggressive to most conservative:



Most aggressive on the left, most conservative on the right. The choice materially changes the level of assets recognised on the balance sheet.

Though The International Accounting Standards Committee tentatively proposed **not allowing the full capitalisation of E&E expenditure**, with non-viable expenditure being amortised against revenue from successful areas (Full Cost), and requiring companies to capitalise all expenditure and writing off expenditure related to unsuccessful projects either as incurred or once that assessment was made (Successful Efforts).

04 — THE REVIEW

What the IASB found

Most recently, in late 2020 a comprehensive review of the accounting practices relating to E&E expenditure was carried out by the IASB, covering more than fifteen hundred entities across the world.

1,531
entities included in the IASB analysis

177
jurisdictions covered by the review

No. 1
Successful Efforts is the most commonly used method

The results show that firms apply a range of accounting policies while **many fail to disclose explicitly the accounting policy applied**. However, according to the IASB analysis, Successful Efforts is the most commonly used accounting method.

CURRENT STANDARD
IFRS 6
Makes no specific requirement for the treatment of E&E costs

STATUS
Discussion Paper published
The first step towards a possible new standard

DIRECTION OF TRAVEL
An IFRS for extractive activities
Would potentially replace or amend IFRS 6

A possible IFRS for extractive activities

The IASB was asked to decide whether to commence a project to replace or amend IFRS 6. A Discussion Paper with findings has recently been published, and the IASB noted that the Discussion Paper is the first step towards a possible IFRS for extractive activities that would address many concerns on the current treatment in light of the significant changes in extractive activities, especially in view of oil and gas markets' volatility, and would potentially replace or amend IFRS 6.

Reviewing your E&E policy?

For further information and or assistance with exploration and evaluation accounting, disclosure and policy choice, please contact us.

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