IFRS 6-EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

1-INTRODUCTION

IFRS 6 addresses the financial reporting for the exploration for and evaluation of mineral resources,including minerals, oil, natural gas, and similar nonregenerative resources. The Standard is intended to provide some limited, initial guidance about the accounting for such activities until the International Accounting Standards Board (IASB) has made a more comprehensive review of the accounting for extractive industries. In particular, the Standard modifies the requirements of other Standards so as to minimize disruption to entities in the extractive industries applying International Financial Reporting Standards (IFRS) for the first time.

More specifically, IFRS 6

• Identifies expenditures to be included in and excluded from exploration and evaluation assets;

• Provides an exemption for exploration and evaluation assets from part of the hierarchy in IAS 8, *Accounting Policies, Changes in Accounting Estimates, and Errors,* of criteria that an entity should use to develop an accounting policy if no IFRS applies specifically to an item;

• Requires an entity that recognizes exploration and evaluation assets to assess such assets for impairment in accordance with IFRS 6 and to measure such impairment in accordance with IAS 36, Impairment of Assets;

• Requires disclosures that identify and explain financial statement amounts that arise from evaluation for and exploration of mineral resources, including

• The entity's accounting policies for exploration and evaluation expenditures; 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.

IFRS 6 was issued in December 2004 and applies to annual periods beginning on or after 1 January 2006.

2-Scope

IFRS 6 applies to expenditures incurred in the exploration and evaluation of mineral resources. It does not apply to expenditures incurred

(a) Before an entity has obtained the legal rights to explore a specific area (i.e., pre-acquisition or pre-exploration expenditures); or

(b) After the technical feasibility and commercial viability of extracting a mineral resource are demonstrable (i.e., development expenditure).

3-DEFINITIONS OF KEY TERMS (in accordance with IFRS 6)

Exploration and evaluation expenditures. Expenditures incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrated. Mineral resources include minerals, oil, natural gas, and similar nonregenerative resources.

Exploration for and evaluation of mineral resources. The search for mineral resources after the entity has obtained legal rights to explore in a specific area as well as the determination of the technical feasibility and commercial viability of extracting the mineral resources.

Exploration and evaluation assets. Exploration and evaluation expenditures that are recognized as assets in accordance with the entity's accounting policy under IFRS 6. Such assets are scoped out of IAS 16, Property, Plant, and Equipment, and IAS 38, Intangible Assets.

4. RECOGNITION

4.1 Development of Accounting Policies

IFRS 6 does not contain recognition requirements for exploration and evaluation assets, so an entity needs to develop its own accounting policies for recognition of such assets.

Practical Insight

Entities follow a wide variety of accounting practices for exploration and evaluation expenditures. At one end of the spectrum, some entities defer nearly all exploration and evaluation expenditure as assets on the balance sheet. At the other end of the spectrum, some entities recognize all such expenditure in profit or loss as incurred. An entity is permitted to continue to apply its previous accounting policies upon adoption of IFRS 6 provided that the resulting information is relevant and reliable.

IFRS 6 permits an entity to develop an accounting policy for recognition of exploration and evaluation expenditures as assets without specifically considering the requirements of paragraphs 11 and 12 of IAS 8 *AccountingPolicies, Changes in Accounting Estimates and Errors*. [IFRS 6.9] Thus, an entity adopting IFRS 6 may continue to use the accounting policies applied immediately before adopting the IFRS. This includes continuing to use recognition and measurement practices that are part of those accounting policies.

Practical Insight

Two common accounting methods in the oil and gas industry are the "full-cost" method and the "successful efforts" method.

Under the full-cost method, all costs incurred in acquiring, exploring, and developing within a broadly defined cost center (e.g., a country or group of countries) are capitalized and amortized. Under this method, costs are capitalized even if a specific project in the cost center was a failure.

Under the successful efforts method, many costs are capitalized and amortized. Unlike the full-cost method, however, costs of unsuccessful acquisition and exploration activities are charged to expense. Costs whose outcome is unknown are either expensed or capitalized

4.2 Changes in Accounting Policies

Once an entity has established accounting policies for exploration and evaluation expenditures, it is permitted to change those policies only 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. The concepts of relevance and reliability are found in IAS 8.

5. MEASUREMENT

5.1 Initial Measurement :

- If an entity's accounting policy results in the recognition of an exploration and evaluation asset, IFRS 6 requires the entity to measure the asset initially at cost.
- An entity is required to determine a policy that specifies which expenditures are recognized as part of the cost of exploration and evaluation assets. That policy should consider the degree to which the expenditure can be associated with finding specific mineral resources.

Examples

Expenditures that according to an entity's policy might be recognized as exploration and evaluation assets include expenditures for

• Acquisition of rights to explore
• Topographical, geological, geochemical, and geophysical studies
• Exploratory drilling
• Trenching
• Sampling
• Activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource

In some cases, general and administrative and overhead costs directly attributable to exploration and evaluation activities might also qualify for recognition as exploration and evaluation assets.
- Expenditures related to the development of mineral resources (i.e., preparations for commercial production, such as building roads and tunnels) cannot be recognized as an exploration and evaluation asset. Property, plant, and equipment used to develop or maintain exploration or evaluation assets also cannot be recognized as an exploration and evaluation asset.

5.2 Classification : An entity classifies an exploration or evaluation asset as either a tangible asset or an intangible asset according to the nature of the asset.
Examples :
Vehicles and drilling rigs would be classified as tangible assets. Drilling rights would be classified as intangible assets.

5.3 Subsequent Measurement :
- After initial recognition, an entity applies one of two measurement models to exploration and evaluation assets:
(1) The cost model
(2) The revaluation model
- Exploration and evaluation assets that are classified as tangible assets are measured in accordance with IAS 16. Those that are classified as intangible assets are measured in accordance with IAS 38.

6. IMPAIRMENT :
6.1-Because of the difficulties in obtaining the information necessary to estimate future cash flows of exploration and evaluation assets, IFRS 6 modifies the requirements of IAS 36 regarding the circumstances in which exploration and evaluation assets are required to be assessed for impairment.
IFRS 6 requires exploration and evaluation assets to be assessed for impairment when facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. Facts or circumstances that may indicate that impairment testing is required include
• The period for which the entity has the right to explore in the specific area has expired or is expected to expire in the near future, unless the right is expected to be renewed.
Substantive expenditure on further exploration and evaluation activities in the specific area is neither budgeted nor planned.

• Exploration and evaluation activities 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.
• Although a development in the specific area is likely to proceed, there is sufficient data to indicate that the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.
6.2- If such facts or circumstances exist, the entity is required to perform an impairment test in accordance with IAS 36, subject to special requirements with respect to the level at which impairment is assessed: In assessing evaluation and exploration assets for impairment, an entity allocates the assets either to cash-generating units or to groups of cash-generating units. Cash-generating units are the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets (e.g., an oilfield). IFRS 6 requires an entity to determine an accounting policy for its allocations. In no case would an entity assess impairment at a level larger than a segment.

7. DISCLOSURE
7.1 IFRS 6 requires an entity to disclose information that identifies and explains the amounts recognized in its financial statements arising from the exploration for and evaluation of mineral resources. Such disclosures include :
• Accounting policies for exploration and evaluation expenditures, including the recognition of exploration and evaluation assets
• The amounts of assets, liabilities, income, and expense, and operating and investing cash flows arising from the exploration for and evaluation of mineral resources
7.2 In addition, an entity is required to make the disclosures required by IAS 16 or IAS 38 consistent with an asset’s classification as either tangible or intangible.
8- **Accounting Treatment of Oil and Gas**
In accordane to IFRS 6 ,it is possible for the facility to apply the methods used by oil and gas companies in American standards. There are two generally accepted methods used by oil and gas exploration companies in the accounting treatment of research costs, which are:
1-**Successful Effort Method**
2-Full Cost Method

Under the successful efforts method, a company only capitalizes those costs associated with the location of new oil and gas reserves when those reserves have been found. If exploration costs are incurred and no new reserves are found, then the costs are instead charged to expense as incurred. Some costs may be capitalized as wells-in-progress until there is additional information about the existence of future benefits; as soon as the additional information becomes available, these costs can either be charged to expense (if there are no future benefits) or reclassified as a fixed asset (if there are future benefits). In the latter case, these costs are amortized as production occurs, so that expenses offset revenues.
The full cost method is a cost accounting method used in the oil and gas industry. Under this method, all property acquisition, exploration, and development costs are aggregated and capitalized into a country-wide cost pool. This capitalization occurs whether or not a well is deemed successful.

Example
Exploration costs for Company (X), one of the oil companies, were as follows**:**

Well n°	Condition	Costs
1	Product	2 Million
2	Product	4 Million
3	Empty	3 Million
4	Empty	2 Million
5	Empty	4 Million
6	Product	5 Million
Total		**20 Million**

Required : The successful efforts method and The full cost method
Solution :
The successful efforts method : According to the successful efforts method, oil reserves will appear at the cost of successful wells only, however unsuccessful wells They are considered period expenses charged to the income statement.
Journal entries

Date	Explanation	Debit	Credit
	Oil stock A/C Prospecting and exploration expenses A/C Bank A/C	11000000 9000000	20000000

The full cost method : According to the total cost method, the oil inventory will appear at total costs as empty wells are charged to successful wells. Therefore, the following entry is established:

Date	Explanation	Debit	Credit
	Oil stock A/C Bank A/C	20000000	 20000000

conclusion

FRS 6 allows entities using quite different accounting policies to all claim adherence to the standard because an entity may continue to use the accounting policies applied immediately before adopting IFRS 6. It was argued that it was too harsh to force those entities that use capitalisation in their accounts to switch to expensing., It was also argued that some entities are created just to carry out exploration, and once this is complete, they sell the rights to the minerals found. If the Conceptual Framework or IAS 36 was applied to these entities, then no assets would ever be recognised. The IASB accepted these arguments and therefore issued IFRS 6.