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Sent: Tuesday, 27 July 2010 11:27 AM
To: AASB Mailbox
Subject: Invitation to Comment Discussion Paper DP/2010/1: Extractive Industries

The Chairman
Australian Accounting Standards Board
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Collins Street West, Victoria 8007
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By E-mail: standard@asb.gov.au

The Project Team is to be congratulated on their Discussion Paper. The two questions that I wish to provide commentary on, from my perspective as an auditor, are:

Q. 7: Testing exploration properties for impairment.

Comment: The recommendation that an exploration property should be written down to its recoverable amount in those cases where management has enough information to make that determination leads the team to the conclusion that in most exploration properties this information is not likely to be available while exploration and evaluation activities are continuing, and particularly when those activities are not yet at an advanced stage.

In my opinion the default position will become exploration properties will not be written down in practice until a much later stage than is presently the case, with the consequence that investors may be relying on Financial Statements that do not show a true and fair view.

The Project Team recognises (at 4.75) this may be the case and recommends safeguards should be provided through disclosures including management's views on why properties continue to be capitalised.

In addition, the Project Team falls into the technical and artificial trap at 4.74(c) of distinguishing the recognition issue of costs that can be initially capitalised; and the measurement issue of capitalised costs that should be written off as impaired; previously recognised by the Project Team at 4.51; and exhibited in the present Australian Accounting Standard AASB 6, Aus 7.2 & 18-20.

Whilst agreeing with the Project Team's "Alternatives to applying IAS 36 to exploration properties: Option C – Identifying other indications of impairment" in my opinion a revised international standard should incorporate objective tests to ensure that exploration losses are recognised in the period during which they are incurred:

- In Australia, this is achieved through the recognition requirements of AASB 6: Aus 7.2 (a) that the rights to tenure are current and (b) (ii), that "active and significant operations in, or in relation to, the area of interest are continuing".

- As pointed out by the Project Team (at 4.67), internationally this is achieved through the measurement requirements of IFRS 6: 18; and as pointed out by the Project Team (at 4.68), in the USA this is achieved by the “sufficient progress” indicators.
- Indicators relating to the recognition and measurement criteria should be combined into the one recognition paragraph to ensure that impaired costs are not be capitalised in the first place.

Concerning the AASB’s separate request for comment on proposals that are in the best interests of the Australian economy.

Comment: I have previously submitted to the AASB that the requirement of AASB 6: Aus 7.2 b) (ii), that “active and significant operations in, or in relation to, the area of interest are continuing” is not a level playing field in that this recognition requirement does not exist internationally, nor to the best of my knowledge in Canada; one of Australia’s major competitors in this sector. Consequently Australian extractive industry companies seeking funding are placed at a competitive disadvantage in so far as international competitors for funds are enabled to strengthen their balance sheets by recognition of assets that fall outside that criterion; and keep such assets on their balance sheet through successfully defending the much more subjective impairment tests.

To establish a level playing field for the benefit of the Australian economy, I recommend that the objectively determinable “active and significant operations in, or in relation to, the area of interest are continuing” test be incorporated into the recognition criteria of any revised international accounting standard.

Q9: Types of disclosure that would meet the disclosure objectives.

Comment: I concur with the Project Team’s recommendation (at 5.23) that reserve information should be disclosed elsewhere in the published financial statements rather than in the notes; so that it is not audited.

In my opinion, to disclose such information within the financial statements would lead to the costs and delays foreshadowed by the Project Team, as the auditor would be obliged to incur the costs of engaging experts due to this extension into areas outside the auditor’s area expertise; together with the resulting costs of increased professional indemnity insurance premiums – all of which would need to be passed on to clients.

The Project Team also recommends that current / fair value measurements be applied to an entity’s reserves (5.24, Table 1) as an indicator of future cash flows.

In my opinion the uncertainties surrounding exploration / evaluation activities, particularly relating to time frames, which in turn impacts pricing and costings, would make this a wholly subjective exercise and potentially lead to abuses. In addition, the expertise required to generate such information would negatively impact the costs (both in monetary and timing terms) / benefit tests. Certainly any such information

would need to be outside the audited financial statements for the reasons stated above.

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