Financial Reporting in the Natural Resources sector

30 November 2023

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Agenda

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considerations

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Today's speakers

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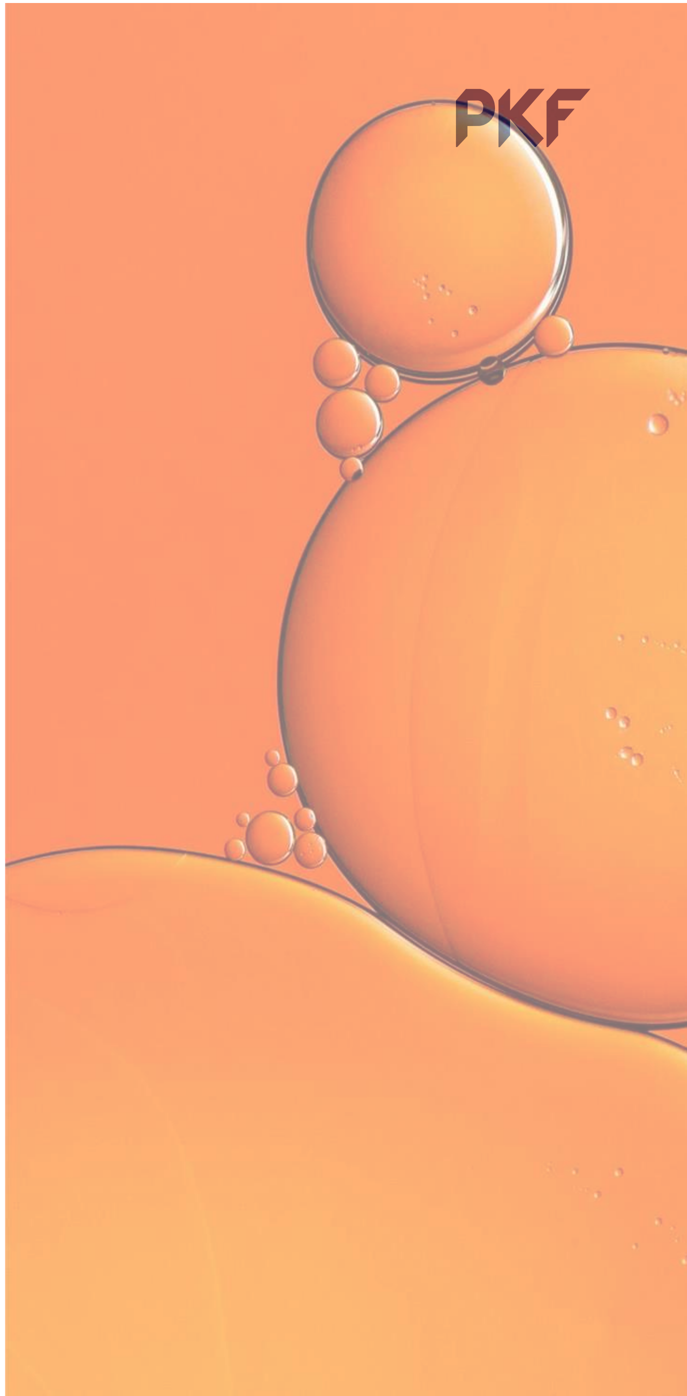
Agenda

- Overview
- Common deficiencies in applying the Standard
- Key areas of management judgement and estimation uncertainty
- Key documentation required by auditors



IFRS 6
and Impairment considerations

Imogen Massey

Overview

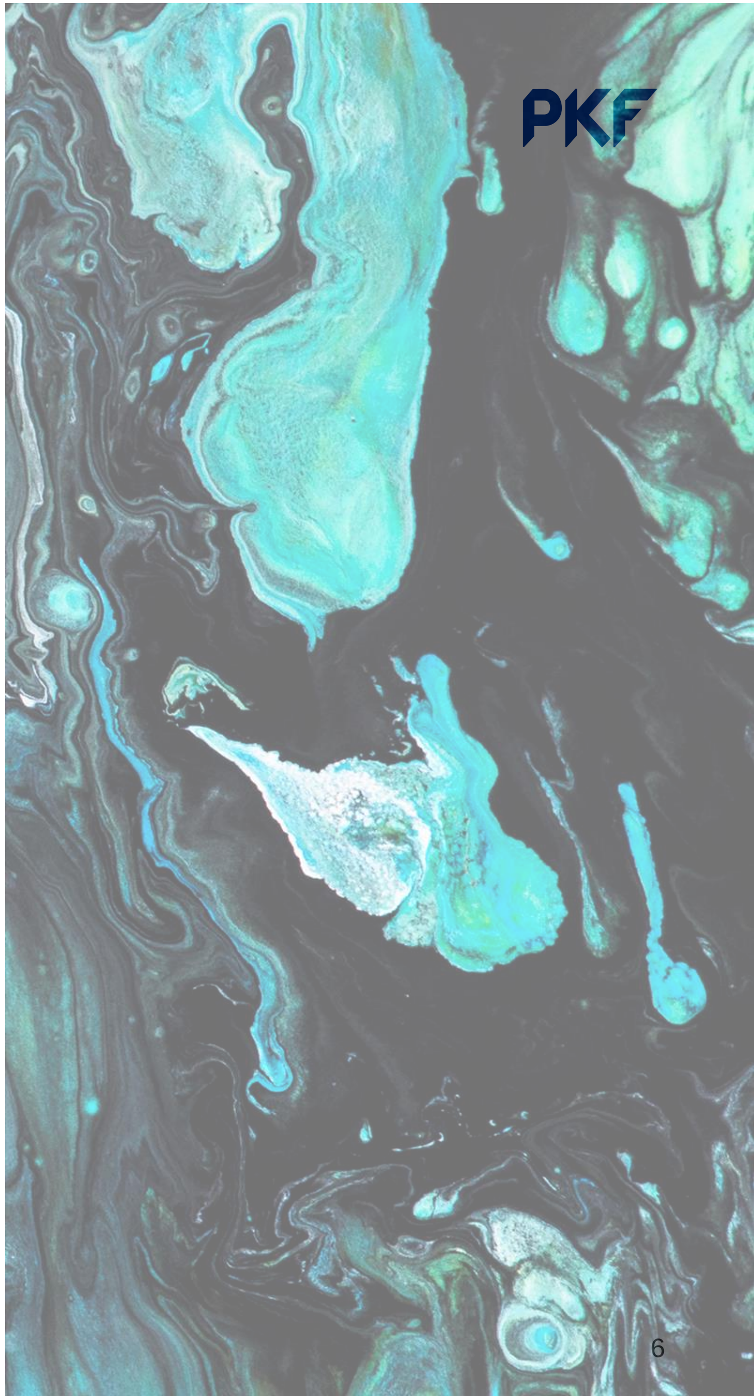
- Objective of IFRS 6: to specify the financial reporting for the exploration for and evaluation of mineral resources

- Who does it apply to?: Exploration stage entities

    - *After* obtaining legal rights

    - *Before* commercial viability

- Requirements relating to impairment – IFRS 6 vs IAS 36



Overview

- Impairment indicators within IFRS 6.20:

    a) the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.
    b) substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned.
    c) exploration for and evaluation of mineral resources 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.
    d) sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation asset is unlikely to be recovered in full from successful development or by sale.

- Other relevant considerations

Common deficiencies

- Insufficiently detailed accounting policies
- Failure to segregate capitalised costs on a sufficiently granular level
- Insufficient detail disclosed relating to judgements made by management

Key areas of management judgement and estimation uncertainty

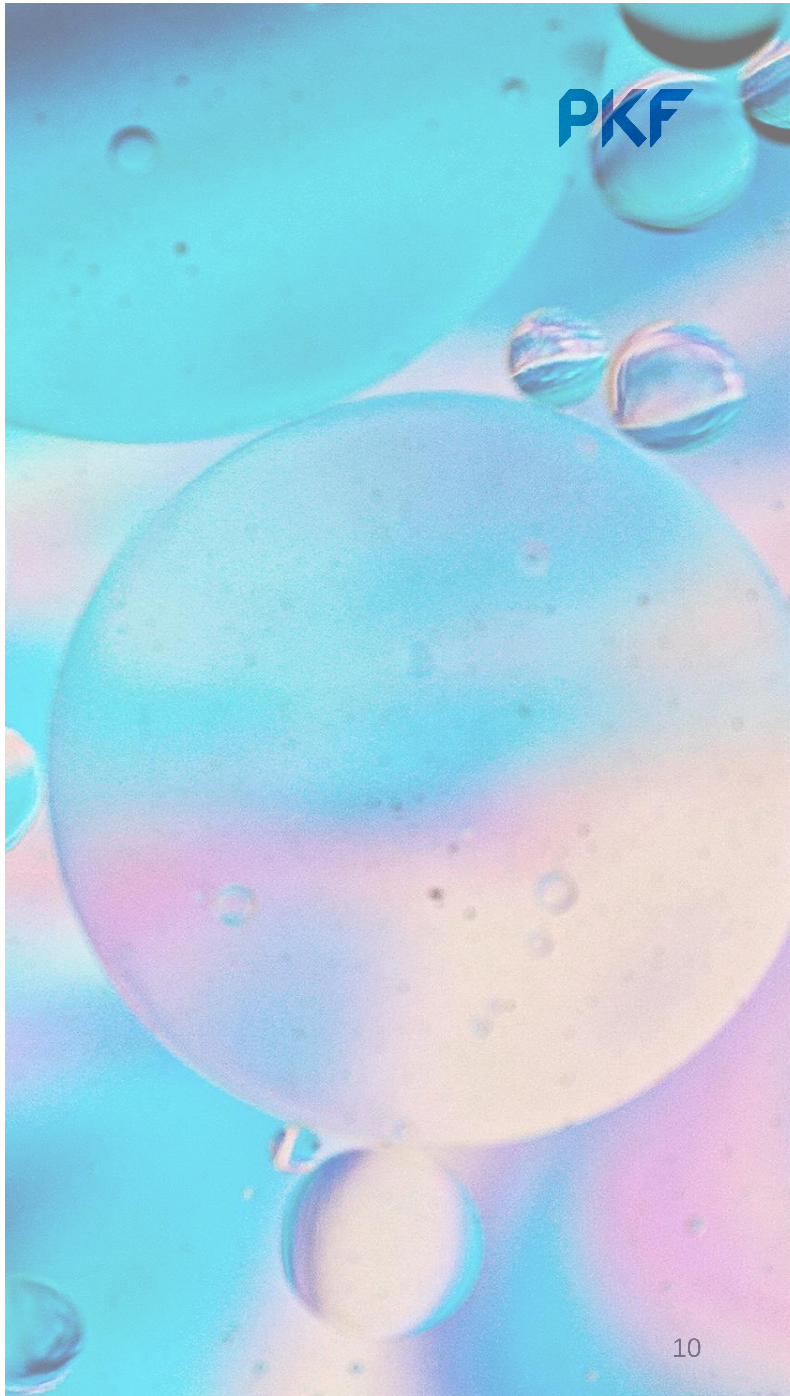
- Determining what elements of cost to capitalise
  - Develop a clear accounting policy
  - Disclose any judgements being made

- Determining whether an impairment arises

- Determining the level of impairment that should be recorded
  - Testing for impairment is challenging when recoverable amount cannot be reliably determined
  - Disclose any judgements being made

Key documentation to be provided to auditors

- Details of the accounting policies being applied
- Current list of licenses held with details of key terms attached
- Detailed breakdown of costs capitalised, showing movements in the year
- Detailed working paper, with support, to show how each one of the criteria under IFRS 6 paragraph 20 has been considered
- Workings supporting any calculation of impairment and details of judgements being made
  - Value of impairment
  - Allocation of impairment



Impairments Under IAS 36

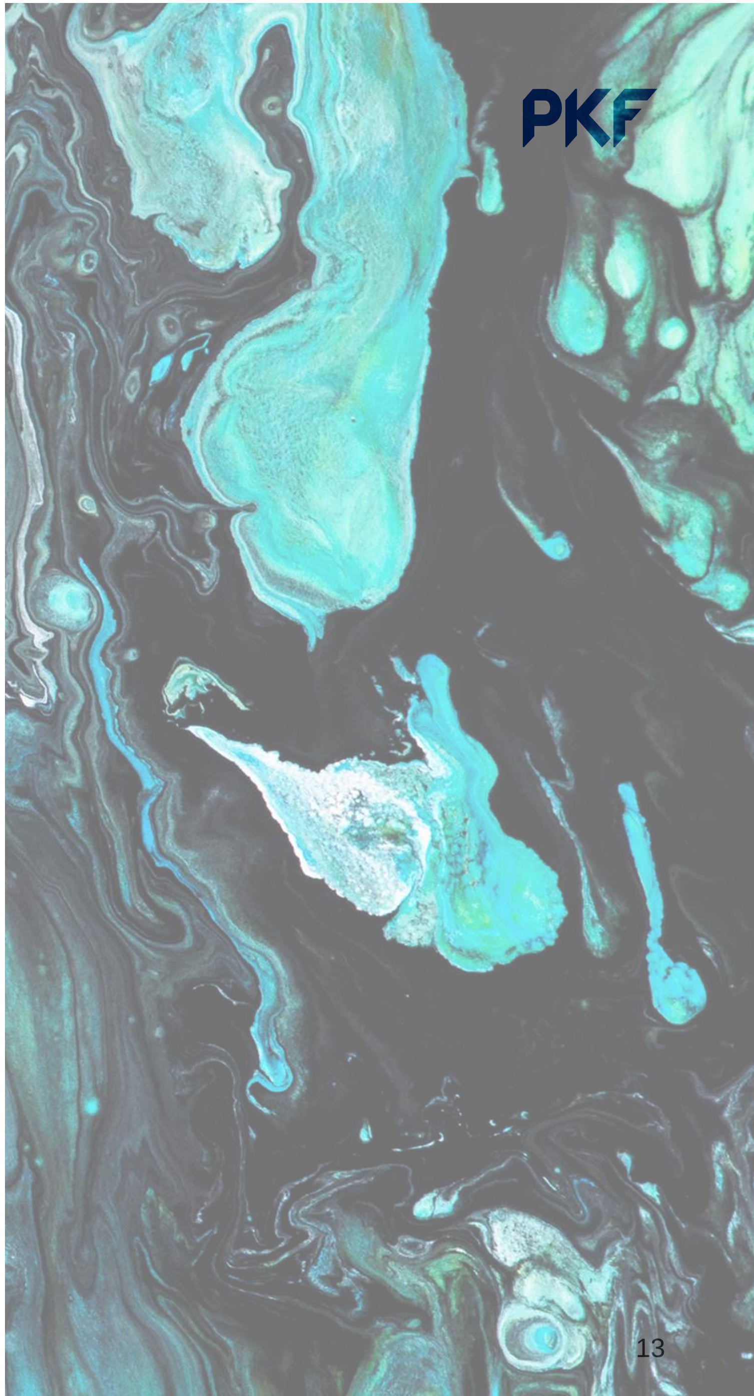
Imogen Massey

Overview

- Objective of IAS 36: to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount
- Carrying value should not exceed amount to be recovered through use or sale of the asset
- Recoverable amount = higher of fair value less costs to sell and value in use
- Early-stage exploration entities:
  - No cash flows generated
  - Insufficient data regarding mineral resource

Overview

- For more advanced projects – information should be available to perform detailed impairment assessment
  - *Advanced exploration phase*
  - *Construction/development*
  - *Production*



Common deficiencies

- Failure to adequately consider relevant external and internal indicators of impairment
- Insufficiently detailed impairment assessment under IAS 36
- Inappropriate discount rate being used in future cash flow workings
- Unrealistic cash flow forecasts being used

Key areas of management judgement and estimation uncertainty

- IAS 36.12 provides a non-exhaustive list of both internal and external indicators of impairment

- If indicators are present – impairment assessment required to ensure CV < RA

- Sources of estimation surrounding:
    - Growth rates
    - Commodity prices
    - Production levels

Key areas of management judgement and estimation uncertainty

- What cashflows to include or exclude

- Applying an appropriate discount rate
  - Weighted average cost of capital (‘WACC’)

- When could you perform this review?
  - Interim impairment assessment
  - Follow up at year end

Key documentation to be provided to auditors

- Detailed cash flow forecast
- Benchmark analysis for a range of appropriate competitors
- Justification for the inclusion of any terminal value
- Sensitivity analysis detailing changes in key assumptions considered to be reasonably possible
- Sufficient historic financial information to support key trends
- Supporting documentation for key contractual or committed income or expenditure

Transitioning categories from exploration to construction through to production

Nick Joel

Objective

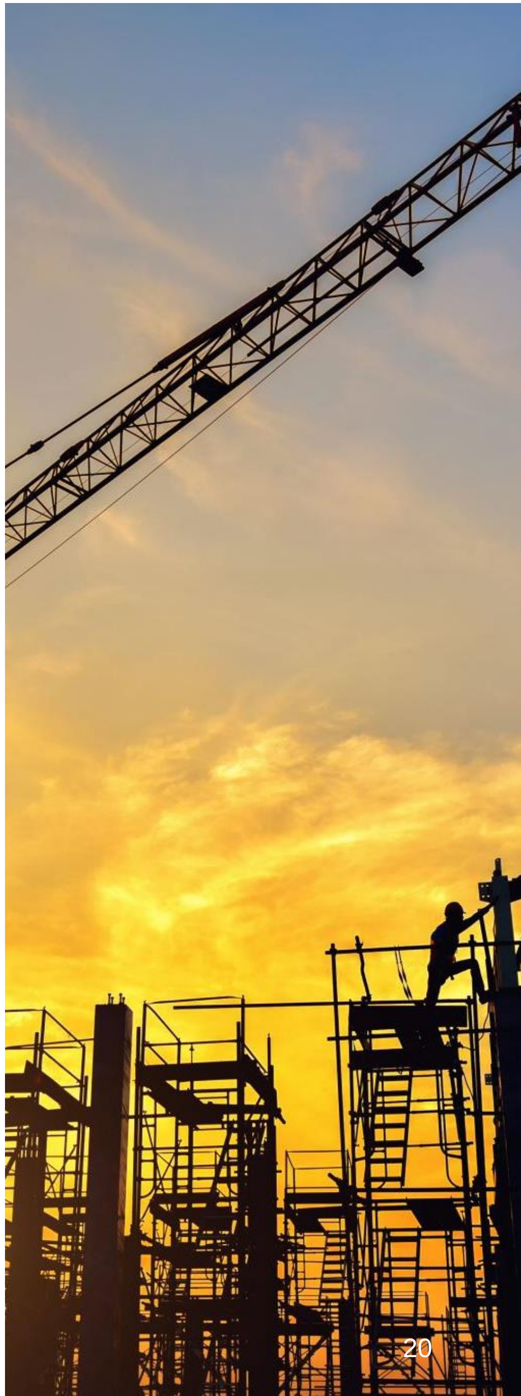
- Understanding trigger points of moving between exploration, mine under construction, and production categories

- Emphasising the role of management judgment and estimation

- How and what estimations should be disclosed

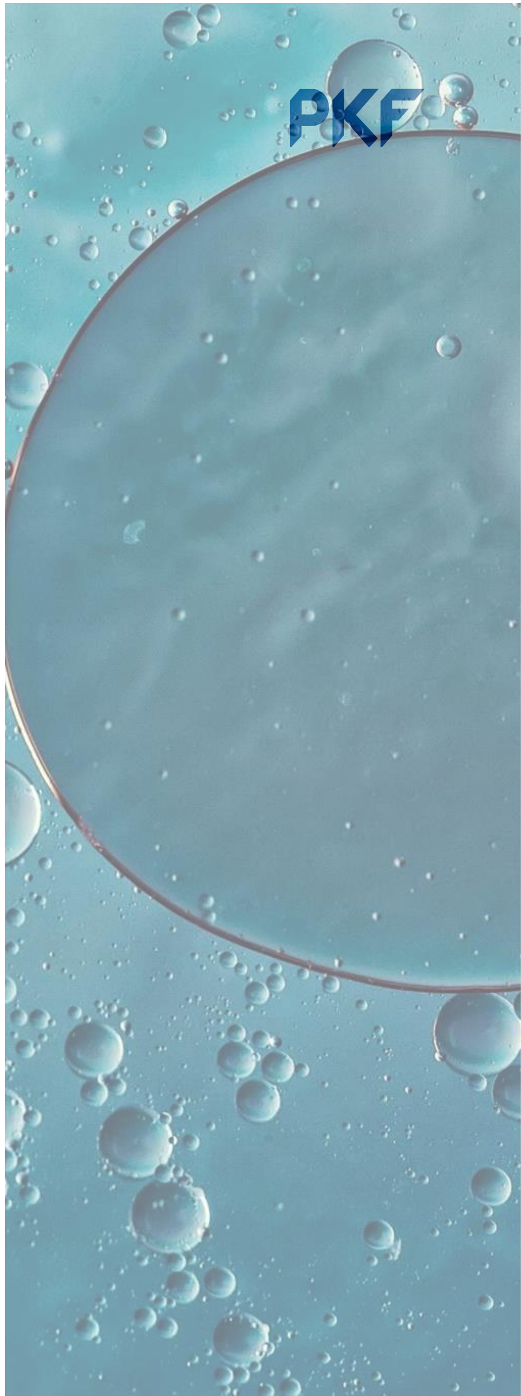
Exploration Phase to Mine Development

- **Recognition of Exploration and Evaluation Assets**
  - Define an accounting policy in line with IFRS 6
  - Ensuring capitalisation criteria is consistently applied
- **Determining Mine Development Stage**
  - Assessing feasibility and viability
  - Considerations: technical studies, permits, financing, and construction activities
  - No longer capitalising as Exploration and Evaluation assets when related to "development"
- **Measurement and Capitalisation of Mine Development Assets**
  - Costs incurred for preparing the mine for production
  - Includes various costs
  - Initial measurement at cost, followed by depreciation



Exploration Phase to Mine Development

- **Trial production**
  - Consideration of revenue generated during mine commissioning
  - Cost of production also to be recognised in profit and loss
- **Commencement of production**
  - When saleable mineral reserves are extracted, leading to revenue generation
- **Transitioning Mine Development Assets to Property, Plant, and Equipment (PPE)**
  - Mine development assets become PPE
  - Carrying amount at transition date becomes PPE cost
- **Depreciation and amortisation of PPE**
  - Depletion over estimated useful lives.
  - Review and adjust useful lives and residual values
- **Impairment**
  - Periodic assessment of mining assets
  - Compare carrying amount to recoverable amount
  - Recognition of impairment loss if carrying amount exceeds recoverable amount



Common deficiencies

- Inadequate Categorisation Justification
- Lack of Detailed Assumptions
- Insufficient Economic Viability Documentation
- Inadequate Recognition and Disclosure of Impairment Losses
- Limited Risk and Uncertainty Disclosure

Key areas of management judgement and estimation uncertainty - overview

Determining and estimating economically viable reserves.

- Estimating reserves and economic potential

Assessing Recoverable Asset Amounts:

- Evaluating the recoverable value of capitalised assets

Estimating Asset Useful Life:

- Determining the expected useful life of assets, including the mine itself

Impairment Assessment

- Identifying impairment indicators and conducting impairment tests

Forecasting Commodity Prices and Exchange Rates:

- Estimating future prices and exchange rates, crucial in the face of market volatility affecting project viability

Cost Allocation Methods:

- Evaluating the appropriateness of used cost allocation methods

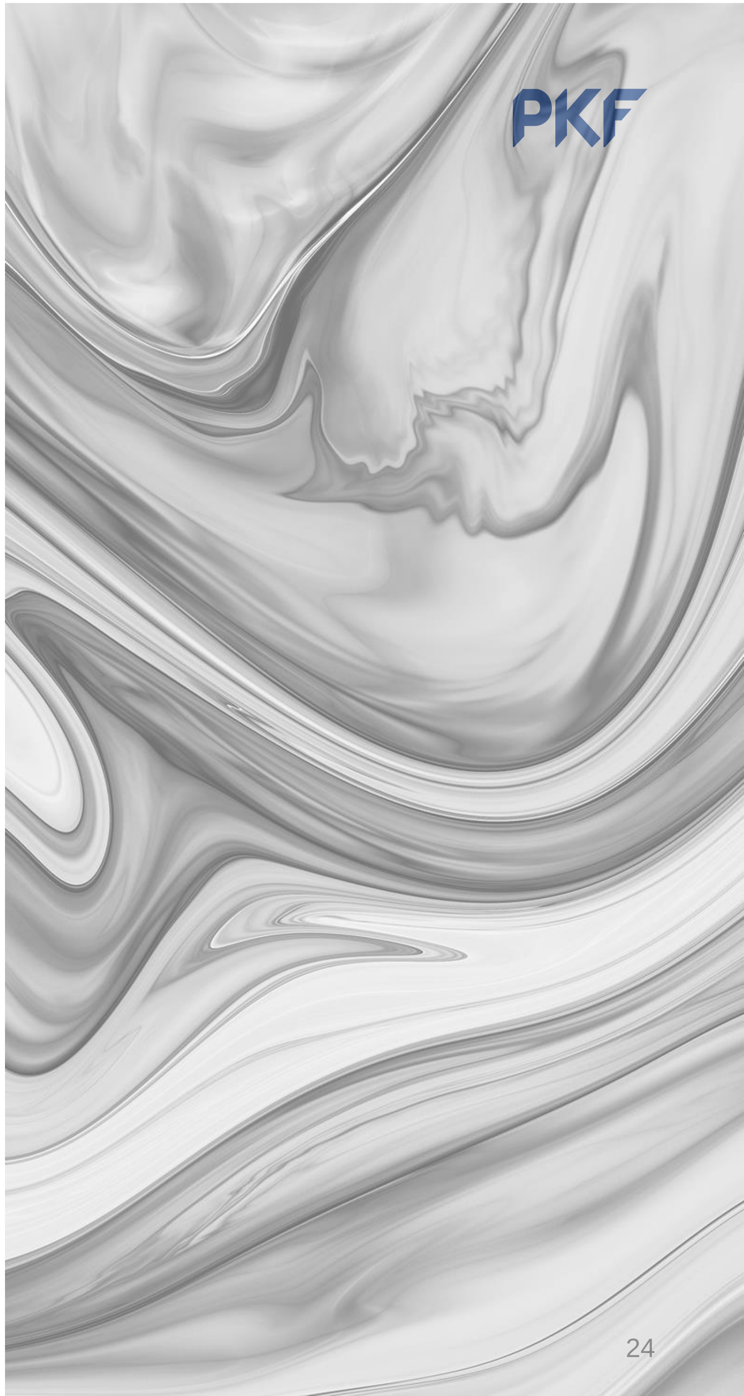
Regulatory and Environmental Compliance:

- Adhering to changing regulatory and environmental requirements
- Careful consideration of permits and licenses as states progress

Technical Feasibility:

- Evaluating technical feasibility during exploration to mine construction transition
- Assessing mining methods, infrastructure needs, environmental impacts and geotechnical factors.

Key documentations



- **Exploration Expenditure Reports:**
  - Auditors review exploration expenditure records. Includes drilling, sampling, and exploration-related costs.
  - Helps validate capitalisation of relevant exploration costs.

- **Exploration and Evaluation Assets:**
  - Examination of company's assessment of exploration and evaluation assets.
  - Evaluates recognition criteria and value measurement in line with accounting standards.

- **Mine Development Plans:**
  - Auditors assess mine development plans. Includes technical reports and engineering studies.
  - Understands progression from exploration to mine development.
  - Ensures appropriate classification of expenditures as development costs.

- **Capital Expenditure Records:**
  - Review of records for capital expenditures during mine development.

- **Project Budgets and Cost Estimates:**
  - Examination of project budgets and cost estimates.
  - Evaluates reasonableness of projected costs during construction and development phases.
  - Ensures assumptions and data are reliable. Covers land acquisition, infrastructure construction, machinery, equipment, and expenses directly linked to mine production initiation.

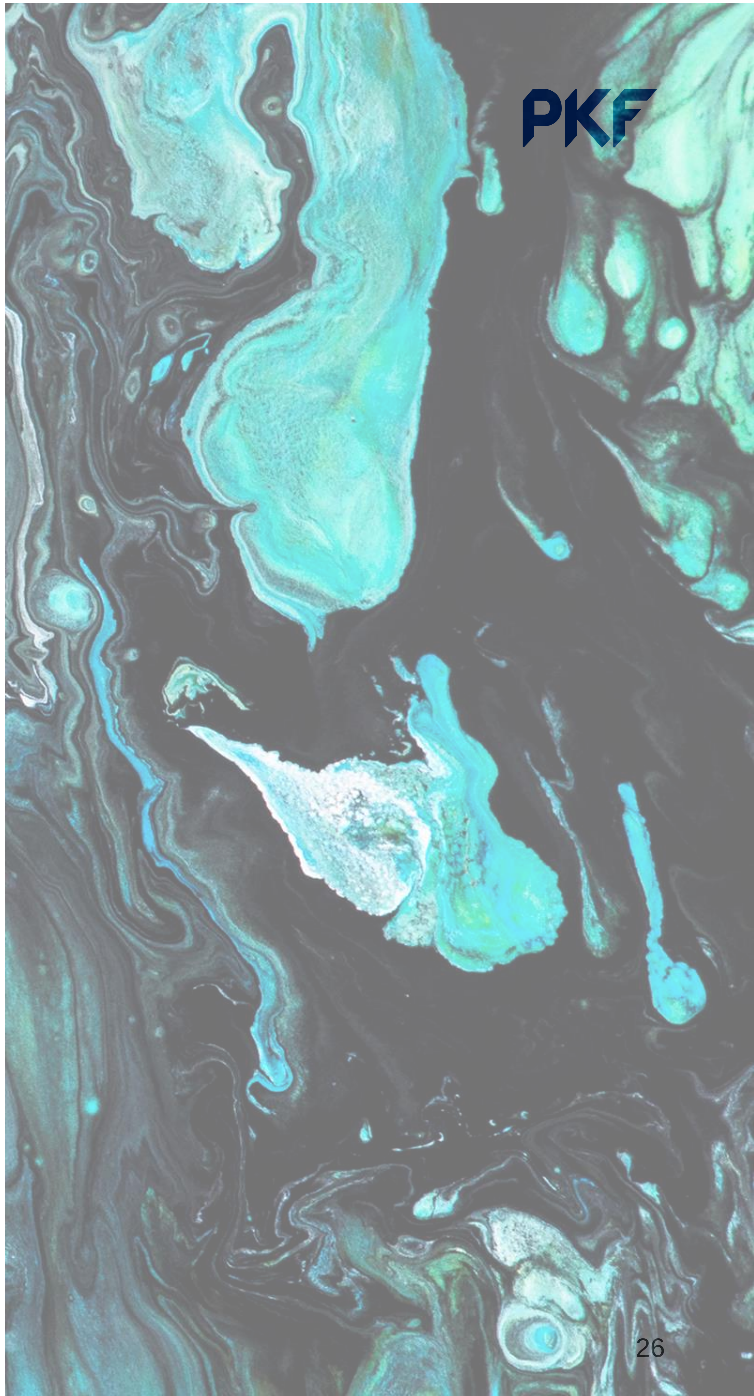
- **Contracts and Agreements:**
  - Audits may request related contracts, including construction, lease, equipment purchase, and service agreements for mine development activities.

Depletion under the Unit of Production Method

Nick Joel

Objective

- An understand of what depletion means
- An overview of the unit of production method
- Understanding the requirements for your business



Common deficiencies

- Inadequate documentation
- Failure to update depletion rate
- Incorrect cost allocation
- Lack of proper disclosure

Initial and subsequent recognition overview

Unit Production Method:

- Initial and subsequent measurement
- Accounts for reduction in natural resource quantity during extraction or use

IAS 16 Requirement:

- Recognition of depletion expense
- Based on units of production method

Initial depletion calculation

- When acquiring or developing natural resource asset
- Calculate depletion cost
- Based on estimated recoverable units
- By dividing acquisition/development cost

Subsequent depletion measurements

- Periodic updates
- As more units extracted or produced
- Represents depletion expense in each accounting period

Cost allocation over useful life

- Unit production method
- Allocates natural resource cost
- Reflects ongoing depletion
- Carrying value reduced by recognised depletion

Annual review for asset lifespan

- Material assets and categories
- Annual review of useful lives and residual values
- Changes to reflected prospectively under IAS 8

Key areas of management judgement and estimation uncertainty

Estimation of recoverable units:

- Management estimates economically recoverable natural resource quantity

Determination of depletion cost per unit:

- Allocating costs for each extracted or sold unit
- Considering factors like exploration, development and restoration costs

Revision of estimates:

- Adjusting unit costs due to changes in reserves or production estimates
- Factors include new geological data or extraction process changes

Estimating the useful lives of major assets

- Potential changes due to external factors affecting asset service potential

Data reliability:

- Gathering accurate data on reserves, production volumes and costs

Consistent policy application:

- Applying depletion policies and methods uniformly

External factors impact:

- Assessing external influences (commodity prices, extraction tech) on recoverable units and unit cost estimation

Key documentations to be obtained as auditors

- **Depletion Policy:**
  - Review the company's depletion policy.
  - Outlines accounting principles and methods, including the unit of production method.

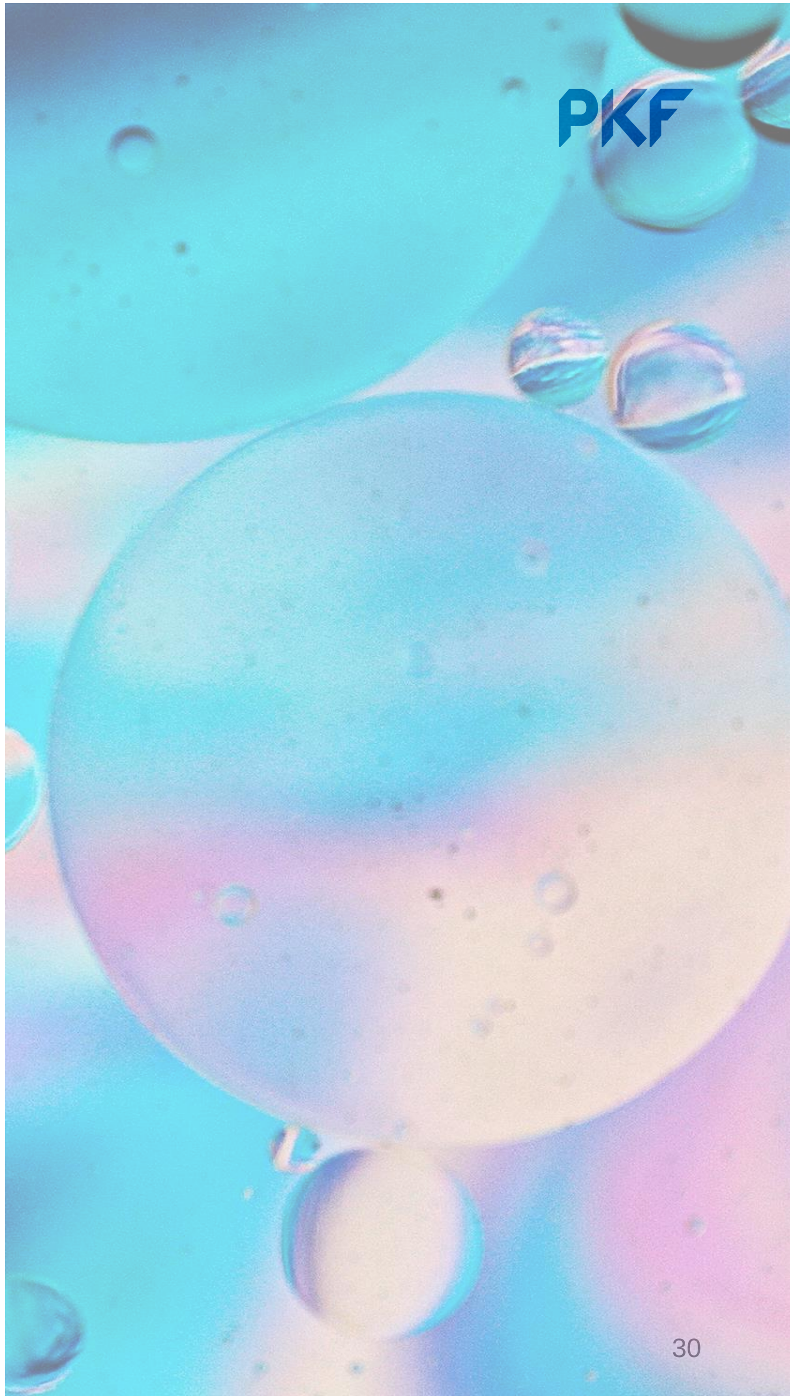
- **Mineral or Resource Reserves Report:**
  - Examine independent expert-prepared report.
  - Estimates mineral or resource reserves held by the company.

- **Production Reports:**
  - Request production reports.
  - Includes data like production volumes, quantities extracted, and resource-specific information for depletion rate determination.

- **Depreciation Schedules:**
  - Scrutinise company's depreciation schedules.
  - Ensures consistency in treating depletion expenses and related assets.

- **Contracts and Agreements:**
  - May ask for copies of contracts related to resource acquisition, exploration, development, or extraction.

- **Management Estimates and Assumptions:**
  - Assess the reasonableness of management's estimates.
  - Includes factors like resource useful life and production volumes.



Accounting for asset retirement, decommissioning, and mine rehabilitation

Lakshmi Upadhyaya

Overview

During the mining phase, extensive excavation and extraction processes are carried out to recover minerals. When a mine reaches its end of life, it is likely that significant costs will need to be incurred in relation to decommissioning and rehabilitation of the mine site to its original state or a safe and stable condition, in compliance with environmental regulations and social responsibilities.

IAS 16, Property, Plant and Equipment, requires companies to recognise a provision for the costs of dismantling and removing an asset, as well as restoring the site on its disposal, if it is probable that such costs will be incurred and can be reliably estimated. A provision relating to these costs should be recognised at the point at which a future liability arises as a result of a present obligation, in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets.

The key drivers of requirements of rehabilitation expenses are:

- Depletion of mineral reserves
- Compliance with legal and environmental regulations
- Social and environmental responsibility
- Safety and public concerns
- Land disturbances

Common deficiencies

Some of the key areas of application deficiencies that have commonly been identified across a wide range of businesses within the natural resources sector, including valuation and disclosure issues, are:

- Complexity of measurement and estimation
- Lack of comprehensive disclosures
- Inadequate consideration of environmental risks

Accounting treatment and key areas of judgement

The initial recognition of a decommissioning provision in the financial statements of mining companies involves estimating the costs associated with dismantling and removing a fixed asset and restoring the site on which it is located. This process ensures that the environmental and social responsibilities related to mine closure and site rehabilitation are appropriately accounted for.

The accounting treatment for decommissioning provision includes the following aspects:

- Present obligation / Estimation of future rehabilitation costs;
- Variation in recognition timing and obligating events
- Capitalisation of estimated costs
- Impairment considerations;
- Subsequent recognition and adjustments
- Involvement of experts.

Key documentation for your auditors

- Agreement/operating licenses issued by the government (local or national), their agencies, the owner of the land, or mineral rights
- Calculation of provision measurement
- Explanation of management's estimation methodology
- Reports from management experts
- Inflation rate and discount rate used

Accounting for Purchase Price Allocation following an acquisition

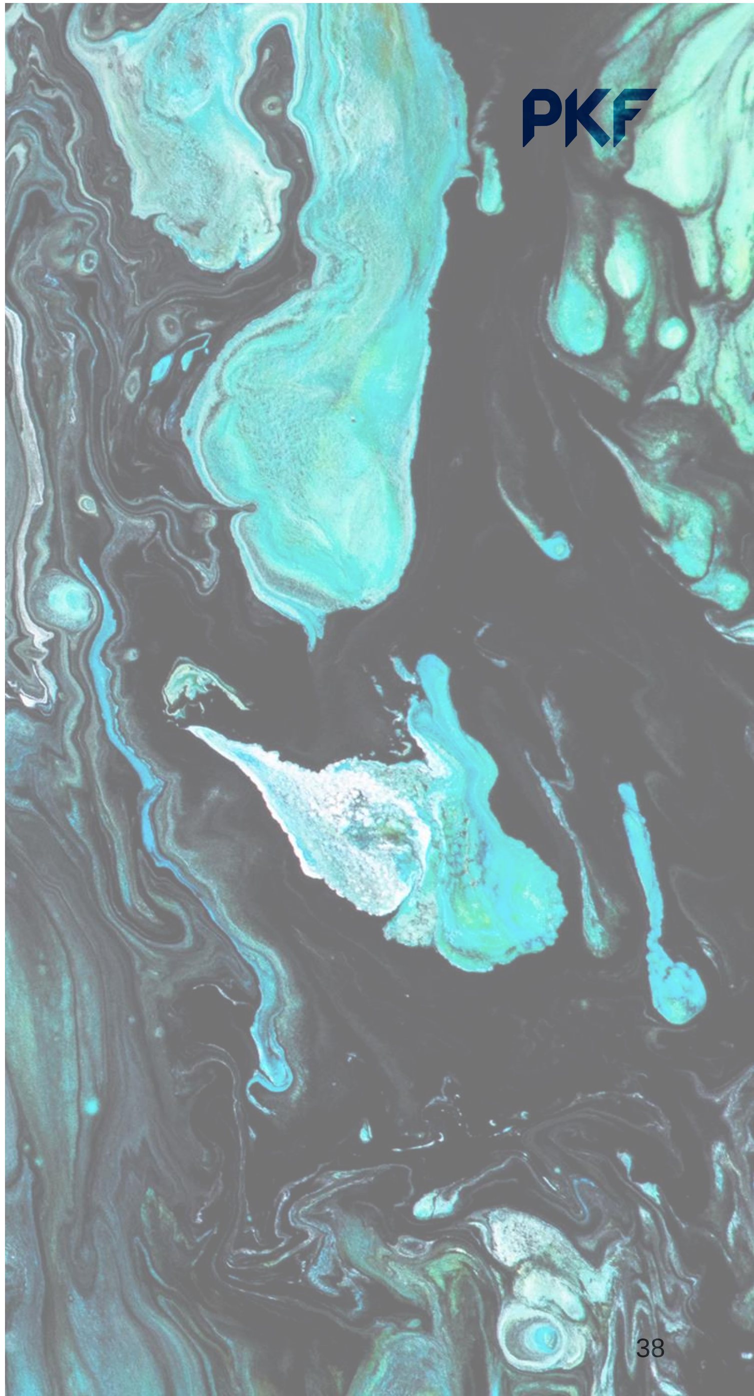
Lakshmi Upadhyaya

Overview

- A Purchase Price Allocation (PPA) allocates the cost of an acquisition to the individual assets and liabilities acquired and is governed by IFRS 3 Business Combinations

There are primarily five steps involved in completing a PPA :

1. Determining the fair value of the consideration paid
2. Identifying the book value of net identifiable assets
3. Fair valuing tangible and intangible assets using business valuation
4. Allocating fair value of the consideration paid to net assets acquired and liabilities assumed
5. Recognising the excess paid of the acquired company’s fair value of net assets less liabilities as goodwill; or recognising the gain on bargain purchases where the consideration paid is less than the fair value of acquiree’s net assets.



Common deficiencies

Some of the key areas of application deficiencies that have commonly been identified across a wide range of businesses within the natural resources sector, including valuation and disclosure issues, are:

- Failure to distinguish between a business combination vs an asset acquisition
- Inappropriate judgements surrounding the valuation of intangible assets:
- Ignoring related tax issues
- Inappropriate allocation between goodwill and separately identifiable assets

Accounting treatment

- For transactions that fall under the scope of IFRS 3, PPA involves a structured process essential for an accurate representation of the acquisition's financial impact. This process unfolds through distinct stages, each playing a pivotal role in determining the fair allocation of consideration and valuing acquired assets and liabilities. Acquirers are granted a "measurement period" extending either until information needs are met or up to twelve months post-acquisition. During this timeframe, acquirers analyse acquired mining properties and exploration assets based on available information. Any adjustments within this period influence the initial business combination accounting. Any adjustments beyond this window are factored into the income statement as changes to estimates.

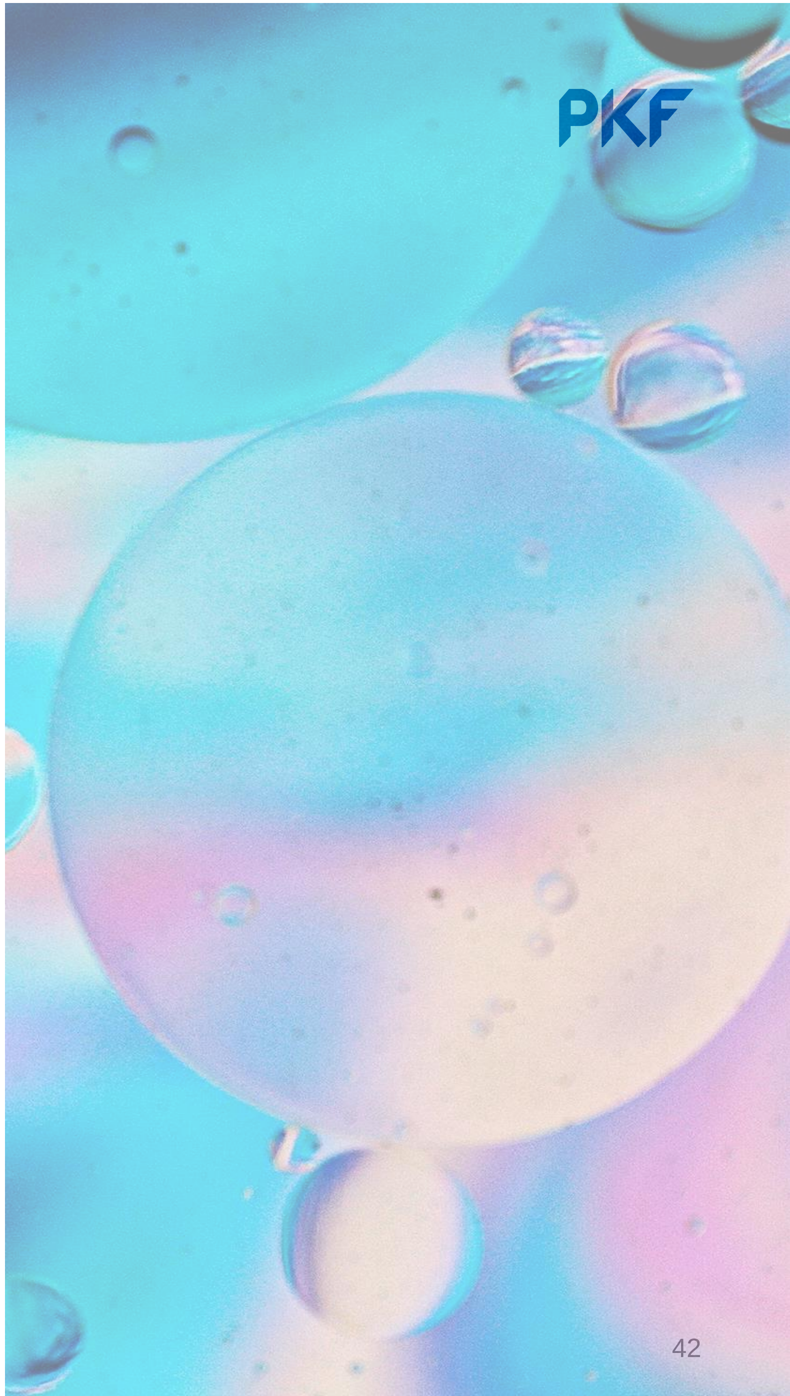
- In an asset acquisition that falls outside the scope of IFRS 3, the acquirer recognises the individual identifiable assets acquired and liabilities assumed at their fair values at the date of acquisition.

Key areas of management judgement and estimation uncertainty

- Intangible asset recognition and tax impact
- Closure and rehabilitation liabilities
- Contract fair value
- Ongoing royalties and contingent consideration
- Additional Consideration:
- Valuation of mineral properties and exploration assets
- Allocation of purchase price to individual assets

Key documentations to be obtained as auditors

- Assessment of whether the acquisition meets the definition of a business in accordance with IFRS 3, supported by rationale
- Business Acquisition agreement confirming purchase price terms and date of acquisition.
- Any business valuation studies/reserve reports where the fair value of assets and liabilities are determined.
- Fair value adjustment workings and supporting evidence for the consideration paid and for the tangible and intangible assets.
- Any relevant valuation reports from management experts used in the resource/reserve estimation.
- PPA and calculation of goodwill, gain on bargain purchase and deferred tax.



Examples of recommended disclosure

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Financial Statement Note

On 31 July 2022, the Group completed the acquisition of Exploration Plc, although it was not able to begin the process of integration and fair value accounting until March 2022. The provisional fair values of the assets and liabilities acquired have been reconsidered in the hindsight period under IFRS 3 and changes to fair values have been made to the extent that these reflect facts and circumstances which existed at the point of acquisition.

	2022 US$'000	**2023 US$'000**	
	Provisional fair value on acquisition	Measurement period Adjustment	Final fair value on acquisition
Total Consideration	50,000		50,000
Assets			
Mining properties	30,000	(2,000)	28,000
Inventories	5,000	(1,000)	4,000
Cash and cash equivalents	5,000	-	5,000
Liabilities			
Decommissioning provisions	(6,000)	-	(6,000)
Deferred tax liability	(4,000)	-	(4,000)
Goodwill arising on acquisition	20,000	3,000	23,000
Total	**50,000**	**-**	**50,000**

Q&A

Any questions?