IFRS 5: Abandonment or Sale of a Mineral Property

Extract, IFRS Discussion Group Report on Meeting – September 13, 2016

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires that entities present separately the post-tax income (or loss) of discontinued operations, including the post-tax gain or loss on disposal, in the statement of comprehensive income. IFRS 5 also requires disclosure of the net cash flows attributable to the discontinued operations.

Entities in the mining industry frequently decide that mineral properties do not warrant further exploration and evaluation work and will abandon their rights to the properties. Alternatively, the entities may sell their rights to the mineral properties rather than undertake further development.

Fact Pattern 1

A reporting entity's (the "Parent Entity") operations consist of the exploration for and evaluation of mineral property interests. The Parent Entity's mineral property portfolio consists of interests located in two countries – Country A and Country B. The mineral properties are held by a subsidiary in each of the two countries – Subsidiary A and Subsidiary B. Each subsidiary has a local manager and staff that are responsible for executing the work plan prepared by the senior management of the Parent Entity. In addition, the staff works with local officials to ensure compliance with applicable laws and regulations and ensure the rights to the mineral properties are maintained. The subsidiaries do not act autonomously and the senior management of the Parent Entity makes all investing and financing decisions. All financing is arranged by the Parent Entity and advanced to the subsidiaries by way of intercompany loans.

During the reporting period, the Parent Entity's senior management decided to focus its exploration and evaluation work on the mineral properties located in Country A. The decision was due to the fact that the mineral properties in Country A showed more promising results and were attracting more interest from investors. Subsidiary B was therefore sold to a third party resulting in a loss on disposal. As a result of the disposal, the group has no further activity in Country B.

Issue 1: Does the sale (or abandonment) of a subsidiary that holds mineral resource interests require presentation as a discontinued operation?

View 1A – The disposal of Subsidiary B should be presented as a discontinued operation.

Under this view, Subsidiary B is considered a "component" as defined by IFRS 5.

Proponents of this view note that Subsidiary B likely represents a separate geographical area of operations given that Subsidiary B had its own manager and employees that were responsible for carrying out the exploration work on mineral properties located in Country B. Further, the mineral properties of Subsidiary B were independent of the assets and operations of Subsidiary A. The exploration work on Subsidiary B's mineral properties resulted in operations and cash flows that can be distinguished from Subsidiary A and the assets were sold to a third party without affecting the other assets of the group.

View 1B – The disposal of Subsidiary B should not be presented as a discontinued operation.

Under this view, Subsidiary B cannot be considered a "component" as defined by IFRS 5.

Paragraph 31 of IFRS 5 indicates that "a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use." Given that Subsidiary B was dependent on the Parent Entity for financing and it was not generating revenues of its own, it likely does not satisfy the definition of a cash-generating unit. Further, the involvement of the senior management of the Parent Entity in all of its strategic decisions prevents it from being clearly distinguishable from the rest of the group, both from an operational and financial reporting perspective.

The Group's Discussion

A question was raised as to whether the fact pattern would be considered an abandonment of a mineral property or held for sale. The fact pattern was clarified to note that Subsidiary B was sold to a third party for nominal value rather than to generate cash flow. One Group member noted that although a sale or abandonment of a mineral property may qualify as a discontinued operation depending on the facts and circumstances, there may be a difference as to the timing of when a discontinued operation presentation can occur. The presentation of discontinued operations only starts in the period when the abandonment actually occurs. However, when assets are being sold, a discontinued operation presentation would occur when the criteria to be classified as held for sale are met.

One Group member questioned whether Subsidiaries A and B would be separate operating segments. A few Group members noted that if the subsidiaries were separate operating segments, presenting the disposal of Subsidiary B as a discontinued operation would be appropriate (View 1A). However, if the subsidiaries were not separate operating segments, then it would not be appropriate to present the disposal of Subsidiary B as a discontinued operation (View 1B). Further, Group members indicated that if there is only one cash-generating unit, it would be difficult to support presentation as a discontinued operation.

One Group member would not preclude View 1A because the added disclosure may have value to users of the financial statements. However, another Group member observed that for junior exploration entities, the additional disclosure may not be particularly useful.

One Group member observed that IFRS 5 includes the notion of an operation that is not necessarily a business. In this fact pattern, there appears to be some form of operation (for example, employees conducting activities) even though the entity is in the exploration and evaluation phase. As a result, there may be room for judgment to be applied to describe what that operation is in the context of this fact pattern. However, another Group member thought that an operation implied more than carrying out an exploration program, but having revenue and outputs as well.

Fact Pattern 2

An entity intends to dispose of a subsidiary after the reporting period end date. The IFRS 5 criteria for classifying as held for sale were met and therefore the subsidiary was classified as such in the entity's consolidated financial statements. It is expected that the proceeds that will be received on the disposal of the subsidiary (which comprises the disposal group) will be at least as much as the carrying value of the net assets of the disposal group plus any disposal costs such that no impairment was recognized. Prior to the reporting period end date, the entity incurred incremental costs relating to the planned disposal of the subsidiary.

Issue 2: What is the appropriate accounting treatment of disposal costs incurred prior to the reporting period end date when the disposal is completed after the reporting period end date?

View 2A – The disposal costs incurred prior to the reporting period end date should be capitalized.

Under this view, the entity is incurring the costs that are related to the planned disposal on the basis that it anticipates that these costs will result in its ability to recover the carrying value of the disposal group plus the disposal costs incurred or to be incurred. As the fair value of the disposal group less costs to sell is higher than the carrying value of the asset, the disposal costs incurred prior to the disposal provide a future benefit to the entity.

View 2B – The disposal costs incurred prior to the reporting period end date should be expensed.

Under this view, incurring costs that are incremental to the planned disposal of a subsidiary does not result in an identifiable asset that should be capitalized. While the costs do relate to an activity that could be viewed as resulting in a future economic benefit to the entity, the criteria for asset recognition are not met. The costs are more appropriately reflected as an expense relating to the period in which the costs were incurred.

View 2C – The disposal costs incurred prior to the reporting period end date should either be expensed or capitalized depending on the nature of the expense.

Under this view, certain costs may be capitalized if incurred to facilitate a sale of the assets to a third party in a manner that will maximize potential proceeds. For example, the entity may incur costs to add to the original service potential of the underlying assets and, therefore, attract more potential buyers or result in a higher price. Other costs, such as selling costs, would normally be expensed because they do not create an identifiable asset.

The Group's Discussion

Group members supported that the disposal costs incurred prior to the reporting period end date should be expensed (View 2B), finding no basis to support deferring such costs.

Some Group members questioned whether the held for sale criteria were met in this fact pattern if the entity is still adding value or incurring costs that would enhance the service potential of the asset. The asset needs to be available for sale in its present condition in order to satisfy the held for sale criteria in IFRS 5.

One Group member noted that if there is an impairment, rather than an anticipated gain on disposal, the treatment of disposal costs is consistent with View 2B. Such costs are not accrued in advance of being incurred but rather IAS 36 requires that the costs to sell to be factored into the determination of the recoverable amount and resulting impairment. Another member noted that the timing of expensing the selling costs can pose interesting questions. For example, if an entity hires an advisor with fees contingent on the successful sale, the contract is an executory arrangement but the trigger for expense recognition is the completion of a successful sale. However, for other types of non-contingent fee arrangements such as hourly fees paid to lawyers or other advisors, amounts are expensed as services are provided to the entity.

The Group recommended that the AcSB consider whether any actions should be taken on the first issue. Such actions could include connecting with CPA Canada's Mining Industry Task Force on IFRSs to raise awareness of the discussions around the meaning of operation and the interaction with the requirements of IFRS 8 *Operating Segments*. No further action was recommended to the AcSB on the second issue.

(For a full understanding of the discussions and views expressed, listen to the audio clip).