

ACCOUNTING AND TAXATION PRACTICES OF SELECTED MINING EXPLORATION
COMPANIES IN SOUTH AFRICA

by

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I declare that ACCOUNTING AND TAXATION PRACTICES OF SELECTED MINING EXPLORATION COMPANIES IN SOUTH AFRICA is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

(Ms J Sturdy)

DATE

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SUMMARY

The promulgation of the Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA) led to a significant increase in the number of junior exploration companies. In this regard, International Financial Reporting Standard (IFRS) 6 allows companies to develop their own accounting policies for exploration and evaluation expenditure. However, there is no definition of either prospecting or exploration in the Income Tax Act 58 of 1962 (Income Tax Act).

The objective of this study was to perform a literature review and to carry out empirical research by using questionnaires that were distributed to junior exploration companies to investigate whether accounting and taxation practices are consistently applied. Accordingly, the findings confirmed that the accounting and taxation practices followed by junior exploration companies are not consistently applied.

Key terms: mineral rights, mineral law, exploration cost, prospecting cost, pre-production cost, mining taxation, extractive industry and junior exploration company

CONTENTS

CHAPTER 1.....	1
INTRODUCTION.....	1
1.1. BACKGROUND TO THE STUDY.....	1
1.2. PRELIMINARY LITERATURE STUDY.....	5
1.3. RESEARCH QUESTION AND HYPOTHESIS	6
1.4. RESEARCH OBJECTIVE.....	6
1.5. RESEARCH METHODOLOGY.....	7
1.6. WHO COULD BENEFIT FROM THE STUDY?	8
1.7. LIMITATIONS OF THE STUDY	8
1.8. LIST OF DEFINITIONS USED.....	9
1.9. LIST OF ABBREVIATIONS AND ACRONYMS USED.....	11
1.10. OUTLINE OF CHAPTERS.....	13
CHAPTER 2.....	15
LITERATURE REVIEW: HISTORICAL OVERVIEW OF MINERAL RIGHTS IN SOUTH AFRICA	15
2.1. INTRODUCTION.....	15
2.2. MINERAL LAW IN SOUTH AFRICA	16
2.2.1. Dutch era	16
2.2.2. British era.....	16
2.2.3. Independent provincial states	17
2.2.3.1. <i>Republic of Transvaal</i>	17
2.2.3.2. <i>Orange Free State</i>	18
2.2.3.3. <i>Natal</i>	18
2.2.3.4. <i>Cape</i>	19
2.2.4. Union era	19
2.2.5. Republic era	20
2.2.6. Present day South Africa	22
2.3. SUMMARY AND CONCLUSION	24

CHAPTER 3.....	26
LITERATURE REVIEW: ACCOUNTING PRACTICES.....	26
3.1. INTRODUCTION.....	26
3.2. PHASES OF MINING.....	27
3.3. MINERAL ASSETS OF EXPLORATION COMPANIES.....	28
3.4. HISTORICAL OVERVIEW OF THE FUNDAMENTAL ACCOUNTING METHODS USED IN THE SOUTH AFRICAN MINING SECTOR.....	31
3.5. OVERVIEW OF IFRS 6.....	32
3.5.1. Objective	33
3.5.2. Scope.....	33
3.5.3. Recognition and measurement of exploration and evaluation assets.....	33
3.5.4. Presentation.....	34
3.5.5. Impairment	35
3.5.6. Disclosure	35
3.5.7. Visual overview of IFRS 6	36
3.6. PRE-EXPLORATION EXPENDITURE	36
3.6.1. The Framework	37
3.6.2. IAS 16, Property, plant and equipment.....	38
3.6.3. IAS 38, Intangible assets	38
3.7. EXPLORATION AND EVALUATION EXPENDITURE.....	39
3.7.1. Developing an accounting policy.....	39
3.7.1.1. <i>Full expense method</i>	41
3.7.1.2. <i>Full cost method</i>	41
3.7.1.3. <i>Successful efforts method</i>	42
3.7.1.4. <i>Area of interest method</i>	42
3.7.1.5. <i>Expense and reinstate method</i>	42
3.7.1.6. <i>Area of interest with provision method</i>	43
3.7.2. Classification	44
3.7.3. Rehabilitation liabilities	44
3.7.4. Measurement	45
3.7.4.1. <i>Cost model</i>	46
3.7.4.2. <i>Revaluation model</i>	46
3.7.5. Impairment	47
3.8. NEW DEVELOPMENTS	49

3.9. SUMMARY AND CONCLUSION	52
CHAPTER 4.....	55
LITERATURE REVIEW: TAXATION PRACTICES.....	55
4.1. INTRODUCTION.....	55
4.2. HISTORICAL OVERVIEW OF MINE TAXATION IN SOUTH AFRICA.....	56
4.3. APPLICATION OF THE INCOME TAX ACT TO EXPLORATION COMPANIES	59
4.3.1. Income from mining operations.....	59
4.3.2. Nature of exploration expenditure	62
4.3.3. Prospecting by a speculator	63
4.3.4. Prospecting to establish a mine.....	66
4.3.4.1. <i>Prospecting and evaluation expenditure</i>	66
4.3.4.2. <i>Investment income</i>	67
4.3.4.3. <i>Disposal of prospecting rights</i>	68
4.3.5. Other tax matters relating to junior exploration companies	68
4.3.5.1. <i>Environmental contributions</i>	68
4.3.5.2. <i>Mineral and Petroleum Resources Royalty Administration Act</i>	69
4.3.5.3. <i>Mineral and Petroleum Resources Royalty Act</i>	69
4.4. VENTURE CAPITAL.....	70
4.5. SUMMARY AND CONCLUSION	72
CHAPTER 5.....	74
RESEARCH METHODOLOGY	74
5.1 INTRODUCTION	74
5.2 LITERATURE REVIEW.....	75
5.3 LIMITATIONS OF THE LITERATURE REVIEW	76
5.4 THE POPULATION.....	76
5.5 THE SAMPLE	78
5.6 DATA COLLECTION METHOD.....	80
5.7 THE QUESTIONNAIRE	82
5.8 DATA ANALYSIS	84
5.9 LIMITATIONS OF THE EMPIRICAL INVESTIGATION.....	84
5.10 SUMMARY AND CONCLUSION	85

CHAPTER 6.....	86
RESEARCH RESULTS	86
6.1 INTRODUCTION	86
6.2 THE QUESTIONNAIRE	87
6.3 RESEARCH RESULTS.....	88
6.3.1. Biographical section	88
6.3.2. New IFRS developments (DP on extractive activities) section	90
6.3.2.1. <i>Scope and approach of extractive activities IFRS</i>	90
6.3.2.2. <i>Definitions of reserves and resources</i>	91
6.3.2.3. <i>Mineral or oil and gas asset recognition model</i>	92
6.3.2.4. <i>Mineral or oil and gas asset measurement model</i>	94
6.3.2.5. <i>Impairment of mineral or oil and gas asset</i>	94
6.3.2.6. <i>Mineral or oil and gas asset disclosure</i>	96
6.3.2.7. <i>Publish what you pay (PWYP) disclosure</i>	103
6.3.3. IFRS 6, Exploration for and evaluation of mineral resources section.....	104
6.3.3.1. <i>Pre-exploration related expenditure</i>	105
6.3.3.2. <i>Accounting policy for exploration and evaluation expenditure</i>	108
6.3.3.3. <i>Classification of exploration and evaluation assets</i>	110
6.3.3.4. <i>Measurement of exploration and evaluation assets</i>	111
6.3.3.5. <i>Impairment of exploration and evaluation assets</i>	114
6.3.3.6. <i>Disclosure</i>	115
6.3.4. Application of the Income Tax Act no 58 of 1962 to junior exploration companies section.....	117
6.3.4.1. <i>Prospecting and exploration expenditure</i>	119
6.3.4.2. <i>Mining income</i>	122
6.3.4.3. <i>Disposal of prospecting rights</i>	125
6.3.4.4. <i>Other tax matters</i>	126
6.4 SUMMARY AND CONCLUSION	129
CHAPTER 7.....	131
CONCLUSIONS AND RECOMMENDATIONS	131
7.1 INTRODUCTION	131
7.2 RESEARCH QUESTION AND HYPOTHESIS.....	132
7.3 RESEARCH OBJECTIVE	133

7.4 RESEARCH FINDINGS	134
7.4.1. Accounting practices	134
7.4.2. Taxation practices	138
7.5 SUMMARY AND CONCLUSION	142
7.6 RECOMMENDATIONS	143
7.7 CONTRIBUTIONS OF THIS STUDY TO THE ACCOUNTING SCIENCES	143
BIBLIOGRAPHY.....	145
Appendix A: Invitation	151
Appendix B: Questionnaire.....	152

LIST OF FIGURES

Figure 2.1: South Africa mineral law eras.....	16
Figure 3.1: Relationship between exploration results, mineral resources and mineral reserves	30
Figure 4.1: Historical overview of mine taxation in South Africa	57
Figure 4.2: Flow Through Shares scheme	71
Figure 4.3: Section 12J (venture capital company)	72

LIST OF TABLES

Table 2.1: Main focus of MPRDA regarding new mineral rights.....	23
Table 3.1: Phases of mining.....	27
Table 5.1: Holders of prospecting rights only.....	77
Table 5.2: Breakdown of number of prospecting rights.....	78
Table 5.3: Breakdown of public company registration dates	79
Table 5.4: Breakdown of company registration dates of companies with more than five prospecting rights each	80
Table 5.5: Summary of respondents	81
Table 5.6: Breakdown of reasons for not responding	82
Table 6.1: Question 3	88
Table 6.2: Question 4	89
Table 6.3: Question 5	89
Table 6.4: Question 6	91
Table 6.5: Question 7	92
Table 6.7: Question 9	94
Table 6.8: Question 10	95
Table 6.9: Question 11	97
Table 6.10: Question 12	99
Table 6.11: Question 13	101
Table 6.12: Question 14	102
Table 6.13: Question 15	103
Table 6.14: Question 17	104
Table 6.15: Question 18	105
Table 6.16: Question 19	106
Table 6.17: Question 20	108
Table 6.18: Question 23	110
Table 6.19: Question 26	112
Table 6.20: Question 27	112
Table 6.21: Question 33	115
Table 6.22: Question 35	115
Table 6.23: Question 36	116
Table 6.24: Question 37	117
Table 6.25: Question 39	118

Table 6.26: Question 40	118
Table 6.27: Question 41	119
Table 6.28: Question 42	120
Table 6.29: Question 43	122
Table 6.30: Question 45	122
Table 6.31: Question 46	123
Table 6.32: Question 50	125
Table 6.33: Question 53	127
Table 6.34: Question 54	127
Table 6.35: Question 55	128

CHAPTER 1

INTRODUCTION

1.1. BACKGROUND TO THE STUDY

The revision of the dual private- and state-owned mineral rights policy of South Africa was initiated by the new political dispensation of the African National Congress (ANC) in February 1994 (Cawood & Minnitt, 1998:374). Common law principles of privately owned mineral rights were replaced with the concept of state custodianship of mineral rights (Keaton Energy, 2008). Revision of the mineral rights policy ultimately resulted in the promulgation of the Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA) in 2004. Sovereignty and custodianship of the nation's mineral and petroleum resources were the fundamental principles contained in section 3 of Chapter 2 of the MPRDA.

The fundamental principles of the MPRDA confirm the ANC's mineral policy view, as contained in its Freedom Charter of 1955 and reads as follows: "The people shall share in the country's wealth!", and "The mineral wealth beneath the soil ... shall be transferred to the people as a whole" (ANC, 1955). Section 3 of Chapter 2 of the MPRDA allows the state to grant prospecting rights to various new investors and role players in the extractive industry of South Africa; this has allowed a significant number of junior exploration companies to become active in this industry (Keaton Energy, 2008). Junior exploration companies are exclusively involved in basic prospecting and exploration activities (Van Blerck, 1992:9–3). Although there are various phases of mining, junior exploration companies are only involved in the pre-exploration and exploration phase. The pre-exploration phase refers to all expenditure incurred before an entity has obtained the legal right to explore a specific area, therefore all expenditure incurred by a junior exploration company before a prospecting right is obtained classifies as pre-exploration expenditure; while the exploration phase begins when the prospecting right is obtained and ends upon completion of a feasibility study (KPMG, 2009).

Revision of the mineral rights policy of South Africa allowed a significant increase of junior exploration companies in the extractive industry of South Africa, but the lack of uniformity and latitude in respect of acceptable accounting practices in the extractive industries has long been recognised (Luther, 1996:67). The following quote from Curle (cited in Luther, 1996:67) in 1905

illustrates that the standardisation of accounting for extractive industries has been debated for a very long time:

I hope that the time is approaching when the system of standardisation will be extended to mining costs and mining accounts. At the present the methods for each of these are legion, and seem designed to conceal rather than reveal the financial position; but there must be some one method, in accounts especially, which is best of all.

With the widespread use of International Financial Reporting Standards (IFRSs), the International Accounting Standards Board (IASB) recognised that extractive activities was an area in which there was little guidance and they were scoped out of most relevant standards (KPMG, 2009). Furthermore, although IFRS 6, *Exploration for and evaluation of mineral resources*, addresses the accounting for exploration and evaluation expenditures, it was developed as an interim standard to allow entities adopting IFRSs to continue to apply their existing accounting policies for these expenditures (IFRS Foundation, 2010). IFRS 6 is to be applied by entities that are engaged in exploration and evaluation of mineral resources (Cengage Learning, 2011); therefore junior exploration companies should apply the standard. IFRS 6 however is applicable only to exploration and evaluation expenditure incurred by such entities after the entity has obtained a legal right to explore a given area (Cengage Learning, 2011). Junior exploration companies should therefore apply IFRS 6 (IASB, 2010a) during the exploration phase, but during the pre-exploration phase junior exploration companies should apply the definitions of assets and expenses from the Framework for the preparation and presentation of financial statements (Framework), and the principles of asset recognition in International Accounting Standard (IAS) 16, *Property, plant and equipment* and IAS 38, *Intangible assets* (KPMG, 2005). IFRS 6 exempts an entity from paragraphs 11 and 12 of IAS 8, *Accounting policies, changes in accounting estimates and errors*, which specify sources of authoritative guidance that must be considered in developing an accounting policy for an item if no IFRS applies specifically to that item (Cengage Learning, 2011). IFRS 6 (IASB, 2010a) therefore allows entities to develop accounting policies for the recognition of exploration and evaluation assets without considering the Framework (IASB, 2010a) and other IFRSs.

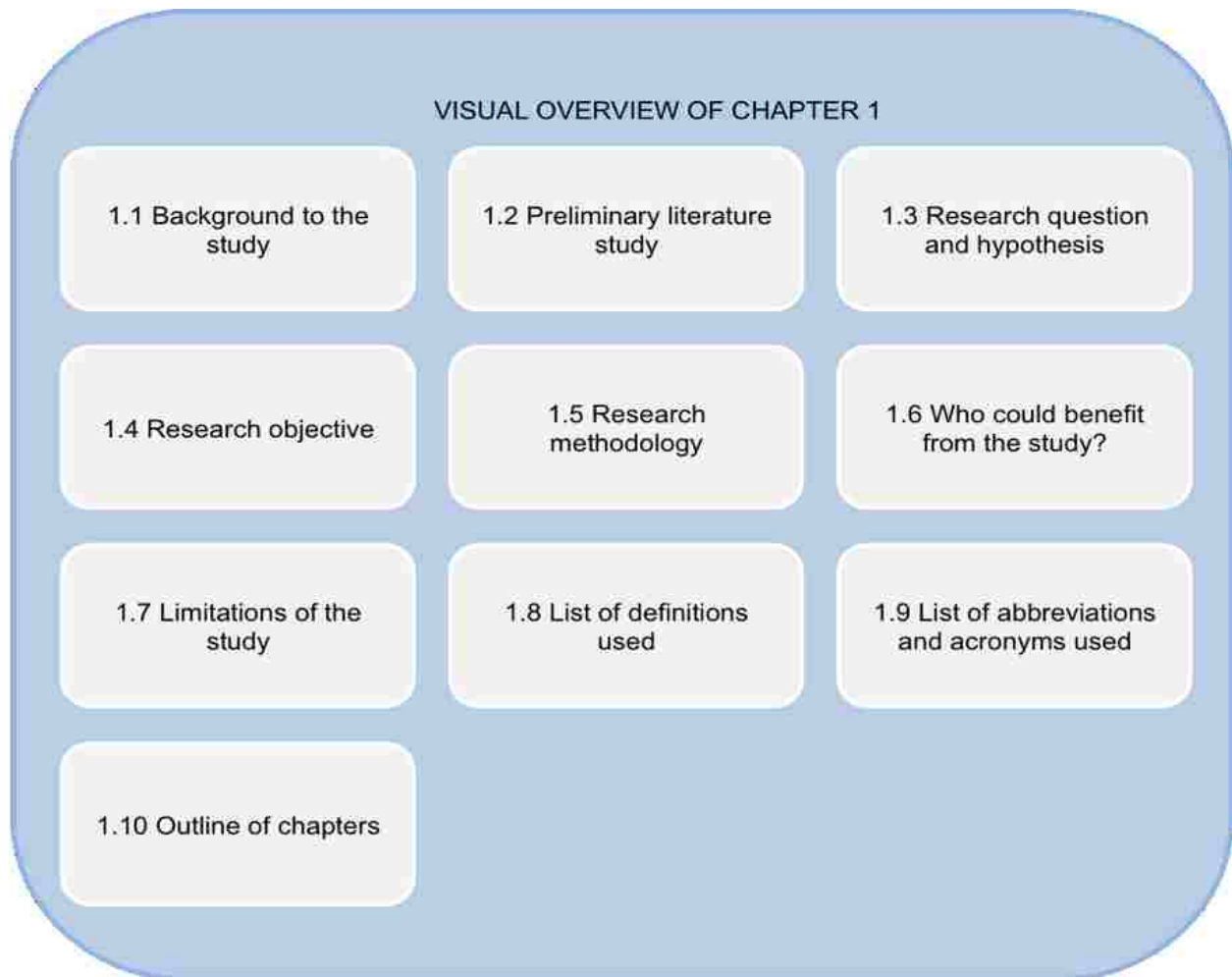
Notwithstanding the requirements of IFRS 6 (IASB, 2010a), the diversity of existing accounting practices for the treatment of exploration and evaluation expenditure still exists. Recognising the

diversity of accounting practices in the extractive industry, the IASB established a project with a view to ultimately issuing a comprehensive standard dealing with the accounting for, and disclosures about, extractive activities (KPMG, 2009). The extractive activities project has never been a high priority for the IASB and progress has been slow (KPMG, 2009). Nevertheless, during April 2010 the IASB issued a discussion paper (DP) (IASB, 2010b) on extractive activities, but the IASB work plan indicates that the IASB plans to make a decision in 2011 as to whether the extractive activities project should be added to its active agenda (IFRS Foundation, 2010). It is clear that a comprehensive standard dealing with extractive industries will be available only in a number of years. Given the absence of clear guidance in IFRS 6 (IASB, 2010a) on the treatment of exploration expenditure and the possibility of various interpretations by junior exploration companies of the definitions of assets and expenses in the Framework (IASB, 2010a) on the treatment of pre-exploration expenditure; the accounting practices of junior exploration companies are not consistently applied.

The chief inspector of mines from the Department of Minerals and Energy (DME) stated in 1997 that, mining houses often held the rights to small deposits they did not wish to exploit and to large resources they intended to mine later down the line (DME, 1997). This meant that junior exploration companies were not able to enter the extractives industry in South Africa (DME, 1997). Jourdan (cited in Cawood & Minnitt, 1998:373) is also of the opinion that the large mining houses held almost all mineral rights before the promulgation of the MPRDA. As a result, these mining houses carried out almost all exploration activities in South Africa. Moreover, mining tax reform did not keep up with the mineral rights reform which was put into place by the MPRDA in 2002 and was last carried out in the early 1990s (Van Blerck, 1991:219), when large mining houses carried out the majority of exploration activities. The terms “mining” and “mining operations” are both defined in section 1 of the Income Tax Act 58 of 1962, as amended (Income Tax Act), although neither the terms “prospecting” nor “exploration” is defined. It is important to determine the nature of exploration expenditure for junior exploration companies, as expenditure of a revenue nature may qualify for deduction in terms of the general deduction formula of section 11(a) of the Income Tax Act, while expenditure of a capital nature may only be deducted if a special deduction provision exists (Van Blerck, 1992:9–4). The Income Tax Act contains special deduction provisions in sections 15, 36 and 37 that pertain to deductions from income derived from mining operations. Section 15(b) of the Income Tax Act specifically deals with expenditure incurred by a taxpayer on prospecting operations.

When a junior exploration company conducts prospecting with the objective of selling the prospecting rights at a profit, the proceeds on disposal will be of a revenue nature and included as gross income as defined by section 1 of the Income Tax Act. Since projects of this character constitute a trade and as the expenditure concerned will be in the production of income, the exploration expenditure will, thus, be deducted in terms of the general deduction formula of section 11(a) of the Income Tax Act, and not according to section 15(b) of the Income Tax Act (Van Blerck, 1992:9–5). When a junior exploration company conducts prospecting with the objective to establish a mine, the exploration expenditure will be of a capital nature and, thus, be deducted in terms of the special deduction provision of section 15(b) of the Income Tax Act. However, in the context of a company that is involved exclusively in basic prospecting and exploration, such a company's prospecting and exploration activities do not constitute "mining operations" as defined in the Income Tax Act (Van Blerck, 1992:9–3). The special deduction provision in section 15(b) of the Income Tax Act is only allowed against income derived from mining operations; therefore, junior exploration companies will not be able to use the special deduction provision as their exploration activities do not constitute "mining operations" as defined in the Income Tax Act. The character of these projects, namely, to establish a mine, is of a capital nature and, thus, the junior exploration company will also not be able to make use of the provision in section 11(a) of the Income Tax Act. As the Income Tax Act does not address exploration expenditure of a capital nature incurred by junior exploration companies, this could lead to various interpretations and taxation practices by junior exploration companies that are not consistently applied.

The layout of this chapter is as follows:



1.2. PRELIMINARY LITERATURE STUDY

The history of mineral law in South Africa is extremely interesting. Cawood and Minnitt (1998) discuss the historical perspective in terms of mineral rights from the era of the Dutch through to the Green Paper that was released for public scrutiny in 1998. The Green Paper revised the dual private- and state-owned mineral rights policy of South Africa to a state-owned only mineral rights policy. The MPRDA was promulgated on 1 May 2004 with the objective to give the state the right to exercise sovereignty and custodianship of the nation's mineral and petroleum resources. Coertse (2005) provides an overview of the MPRDA and maintains that the MPRDA has increased the number of junior exploration companies in the South African extractive industry significantly.

Luther (1996: 67) notes that the lack of uniformity and latitude in respect of acceptable accounting practices in the extractive industries has been recognised over a long period. Junior

exploration companies form part of the extractive industry. The South African Institute of Chartered Accountants (SAICA) has issued a booklet on the accounting and reporting practices of the extractive industry (SAICA, 1995), while PriceWaterhouseCoopers (PWC) has also issued a booklet on financial reporting for the mining industry in the 21st century (PWC, 1999). These booklets were issued before the big drive towards the adoption of IFRS and explain the accounting guidelines that were followed by the mining industry during that time. Even with the issue of the booklets, Luther (1996), Tollington (1997), Gerhardy (1999) and Venter (2003) all discuss the various methods that companies use in order to account for pre-production costs (exploration and evaluation costs) and they also address the need for specific accounting regulations in the extractive industries. The International Accounting Standards Board (IASB) has issued IFRS 6 (IASB, 2010a) for the accounting of the exploration and evaluation of mineral resources. Williamson (2005a; 2005b), Nichols (2005) and Chung and Narasimhan (2006) discuss the implications, if any, of IFRS 6 (IASB, 2010a) for the accounting and reporting of the exploration and evaluation costs for companies.

The subject of mining taxation in South Africa is vitally important. The late 1980s and the early 1990s saw a review being conducted on mining taxes in South Africa. Otto (1987) examines the taxation of mineral rights while Van Blerck (1990; 1991) discusses the recommendations of the proposed 1991 tax amendments, which are of relevance to mines. Van Blerck (1992) is the first published text devoted exclusively to the taxation of the mining industry in South Africa and is still used as an authoritative source for guidance on mining taxation.

1.3. RESEARCH QUESTION AND HYPOTHESIS

The research question of this study is formulated as follows:

Are the accounting and taxation practices applied by junior exploration companies in South Africa consistent?

The hypothesis of the study is that junior exploration companies in South Africa do not consistently apply accounting and taxation practices.

1.4. RESEARCH OBJECTIVE

The objective of the study was to perform a literature review and to carry out empirical research by using questionnaires that were distributed to junior exploration companies to investigate whether accounting and taxation practices are consistently applied.

1.5. RESEARCH METHODOLOGY

The methodology used in this study was a literature study and a self-administered survey. The literature review was based on key words such as mineral rights, mineral law, exploration cost, prospecting cost, pre-production cost, mining taxation, and exploration companies. However, please note that this is not a complete list of key words. The main sources of information for the literature review were the electronic library (i.e. Oasis) of the University of South Africa (UNISA), International Financial Reporting Standards (IFRSs), the South African Income Tax Act no 58 of 1962 and internet websites.

The study provided a brief history of the ownership of mineral rights in South Africa. This brief history served as background for understanding the impact that mineral rights have on the welfare of the mining industry and junior exploration companies. It is not a comprehensive description of the history of mineral rights in South Africa. The process which has to be followed in order to obtain a prospecting right according to the MPRDA is briefly described. This served as background for understanding exactly when an entity received the legal right to explore a specific area.

The research is limited to a critical evaluation of the accounting treatment of exploration and evaluation costs by junior exploration companies according to the standards issued by the IASB. However, in view of the fact that IFRS 6 (IASB, 2010a) allows an entity to develop an accounting policy for exploration and evaluation assets for itself, this study identified and described the different accounting treatments of exploration and evaluation costs in the mining industry.

The study also briefly examined the capital and revenue nature of expenditure-related exploration activities according to the Income Tax Act, case law and other publications. In addition, the study investigated the Income Tax Act and interpretations from case law and other published texts to identify and discuss the tax practices of exploration and evaluation costs for junior exploration companies.

The study involved a self-administered survey with a web-based survey being used to collect the accounting and taxation-related data from junior exploration companies. LimeSurvey was the survey tool used. The Bureau of Market Research at UNISA administered the web survey on behalf of the researcher. This study used purposive, non-probability sampling. The sample selected for this study comprised those companies with more than five prospecting rights each

and with company registration numbers, dating from at least the year 2004. The sample comprised two public companies and 56 private companies. This was an exploratory study and the results of the empirical investigation were not generalised to the population.

1.6. WHO COULD BENEFIT FROM THE STUDY?

Junior exploration companies could benefit from this study as it presents the current accounting practices for the treatment of exploration expenditure and also provides an overview of the DP on extractive activities (IASB, 2010b) that could influence the accounting practices of junior exploration companies in the future. This study provides information that could enable junior exploration companies to determine their accounting policies for exploration and evaluation expenditure and inform them on the possible future changes in their accounting for exploration and evaluation expenditure. Junior exploration companies could also benefit from the discussion on the various interpretations of the Income Tax Act on the taxation treatment of exploration expenditure, as this provides them with some guidelines on the taxation treatment of exploration expenditure.

Those individuals and bodies responsible for drawing up accounting standards and income tax law will also benefit from this study, as the study enables them to consider the current accounting and taxation practices of junior exploration companies in South Africa.

1.7. LIMITATIONS OF THE STUDY

The literature review included an examination of accounting policies and practices for exploration expenditure in the extractive industry; however, the literature does not distinguish between junior exploration companies and mining companies.

Mining tax reform was last carried out in the early 1990s, when large mining houses carried out most of the exploration work. The amount of literature available on the taxation practices of junior exploration companies is limited and dates back to the early 1990s. The practical interpretations of the Income Tax Act were obtained from case law, the Marais Committee report (Marais, 1988), the publication *Mining tax in South Africa* by Marius van Blerck (Van Blerck, 1992) and *A guide to mining taxation in South Africa* issued by KPMG in 1993 (KPMG, 1993). The Marais Committee was the last Committee appointed by the government to specifically look at matters relating to mining taxation (Marais, 1988). The limited literature

available on accounting and taxation practices for junior exploration companies is, therefore, a limitation.

The sample selected for this study comprised companies with more than five prospecting rights each and with company registration numbers dating from the year 2004. The sample ensured that the information obtained for the study were from new role players in the extractive industries. The sample comprised two public companies and 56 private companies. The responses received represented eleven companies and cannot be generalised to the population, this could be seen as a limitation.

1.8. LIST OF DEFINITIONS USED

For the purpose of this study the terms below are defined as follows:

Accounting practices:

Accounting practices refer to the manner in which accountants and auditors carry out their daily work. In other words, these practices have to do with the day-to-day implementation of accounting policies and relate to the practical application of accounting to the financial accumulation and reporting needs of clients. In reality, practices may differ from accounting theory (Anon., 2008). Belkaoui (cited in Cronjé, 2008) states that accounting practices stem from prevailing industry practices. Subsequently, accounting practices generate the accounting information disclosed in corporate annual reports (Cronjé, 2008).

Consistent:

As an adjective, consistent refers to something done in the same way over time, especially so as to be fair or accurate (Oxford Dictionary, 2011b). The adverb of consistent is consistently (Oxford Dictionary, 2011b). Junior exploration companies in South Africa do not consistently apply accounting and taxation practices. Therefore, consistently apply refers to accounting and taxation practices done in the same way over time on a company-to-company basis.

Exploration:

Exploration refers to the search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources, after an entity has obtained the 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 (IFRS 6, App. A (IASB, 2010a)).

Extractive activities:

Exploring for and finding minerals, oil and natural gas deposits, developing those deposits and extracting the minerals, oil and natural gas are referred to as extractive activities or upstream activities (DP on extractive activities, IASB, 2010b). The terms “extractive activities” and “extractive industries” are equivalent terms.

Junior exploration company:

A junior exploration company refers to a company that is involved exclusively in basic prospecting and exploration activities (Van Blerck, 1992:9–3).

Junior mining company:

A junior mining company is any company that is carrying on a trade in mining exploration or production only. Such a company may either be an unlisted company or the company may be listed on the alternative exchange division of the Johannesburg Securities Exchange (JSE) Limited (Income Tax Act, s 12J).

Mineral:

Mineral refers to any substance, whether in solid, liquid or gaseous form, which occurs naturally in or on the earth or in or under water and which was formed by or subjected to a geological process. Mineral includes sand, stone, rock, gravel, clay, soil and any other mineral which occurs in either residue stockpiles or in residue deposits, but excluding water, other than water taken from land or sea for the extraction of any mineral from such water, petroleum or peat (MPRDA, ch 1).

Mine:

As a verb, the word “to mine” refers to any operation or activity which is carried out for the purposes of winning any mineral on, in or under the earth, water or any residue deposit, whether by underground or open working or otherwise, and which includes any operation or activity incidental thereto (MPRDA, ch 1).

Mining operations:

Mining operations refer to any operation relating to the act of mining as well as matters directly incidental to this act of mining (MPRDA, ch 1).

Prospecting:

Prospecting refers to the intentional searching for any mineral by means of any method which disturbs the surface or subsurface of the earth, including any portion of the earth that is under the sea or under water; or in or on any residue stockpile or residue deposit, in order to establish the existence of any mineral and to determine the extent and economic value of such mineral; or in the sea or other water on land (MPRDA, ch 1).

Taxation practice:

Practice is the actual application or use of an idea, belief or method as opposed to the theories relating to it (Oxford Dictionary, 2011a). Practice is the actual doing of something, as opposed to the theory (Anon., 2011). Therefore, taxation practice refers to the actual application of taxation law or, in other words, to the practical application of tax law.

The terms “exploration” and “prospecting” are equivalent terms although the term “exploration” is used in IFRS 6 (IASB, 2010a), whereas the term “prospecting” is used in both the MPRDA and the Income Tax Act.

1.9. LIST OF ABBREVIATIONS AND ACRONYMS USED

Abbreviations and acronyms used in this study include:

ANC	African National Congress
BBSEE	Broad-based socio-economic empowerment
CGU	Cash generating units
CIPRO	Companies and Intellectual Properties Registration Office
CIR	Commissioner for Inland Revenue
COT	Commissioner of Taxes
CRIRSCO	Committee for Mineral Reserves International Reporting Standards
DME	Department of Minerals and Energy
DMR	Department of Mineral Resources
DMEA	Department of Mineral and Energy Affairs
DP	Discussion paper
FASB	Financial Accounting Standards Board
FMF	Free Market Foundation of Southern Africa
FTS	Flow through shares

GAAP	Generally Accepted Accounting Practice
GSSA	Geological Society of South Africa
IAS(s)	International Accounting Standard(s)
IASB	International Accounting Standards Board
IFRS(s)	International Financial Reporting Standard(s)
IFRIC	International Financial Reporting Interpretations Committee
ITC	Income Tax Case
JSE	Johannesburg Securities Exchange
JV	Joint venture
MPRDA	The Mineral and Petroleum Resource Development Act 28 of 2002
MPRRA	The Mineral and Petroleum Resources Royalty Act 28 of 2008
MPRRAA	The Mineral and Petroleum Resources Royalty Administration Act 28 of 2008
PPE	Property, plant and equipment
PRMS	Petroleum Resource Management System
PWC	PriceWaterhouseCoopers
PWYP	Publish what you pay
RDP	Reconstruction and Development Programme
SAMCODE	The South African Mineral Codes
SAMREC	The South African Code for the Reporting of Exploration Results
SAMVAL	The South African Code for the Reporting of Mineral Asset Valuation
SAICA	South African Institute of Chartered Accountants
SAIMM	South African Institute of Mining and Metallurgy
SARS	South African Revenue Services
SATC	South African Tax Case
SCA	Supreme Court of Appeal
SIR	Secretary for Inland Revenue
UNISA	University of South Africa
VCC	Venture capital company

1.10. OUTLINE OF CHAPTERS

This study comprises seven chapters.

Chapter 1: Introduction and background

This chapter contains an explanation of the background to the study. In addition, the research question and hypothesis are defined and the research objective of the study described. The chapter also presents the research methodology and delineates the scope of the study.

Chapter 2: Literature review: Historical overview of mineral rights in South Africa

The minerals industry in South Africa has developed from 1652 to the present day. This chapter provides a historical overview of mineral rights ownership in South Africa. This overview gives information regarding the origin of the mining industry in South Africa in general and specifically illustrates how a mineral rights policy can influence the number of junior exploration companies in existence. The process of obtaining a prospecting right, according to the MPRDA, is also described; this is important as the exploration phase only starts when a prospecting right is received.

Chapter 3: Literature review: Accounting practices

The phases of mining are described as a junior exploration company is only involved in the pre-exploration and exploration phase. In addition, the main asset of a junior exploration company is described. Before the drive towards IFRS, SAICA issued a guideline entitled Accounting and Reporting Practices in the Mining Industry, the specifications of which are discussed in this chapter. The accounting treatment and practices of pre-exploration expenditure in terms of the Framework (IASB, 2010a) and other accounting standards are also discussed. The accounting treatment of exploration expenditure is included in the scope of IFRS 6 (IASB, 2010a); therefore the main features of IFRS 6 (IASB, 2010a) are investigated in this chapter. IFRS 6 (IASB, 2010a) permits an entity to develop its own accounting policy for its exploration and evaluation assets; consequently, the various accounting practices for exploration and evaluation costs are examined. Finally, the chapter describes the recommendations on extractive activities contained in the DP (IASB, 2010b) which were issued by the International Accounting Standards Board (IASB) in April 2010.

Chapter 4: Literature review: Taxation practices

The chapter provides a short history of the development of mining taxation in South Africa, which shows that mining tax reform was last carried out in the early 1990s, when large mining houses carried out most of the exploration work. Furthermore, the capital and revenue nature of exploration expenditure are examined in this chapter, which also investigates the Income Tax Act and identifies and discusses the possible practical applications of this Act by junior exploration companies.

Chapter 5: Research methodology

This chapter discusses the methodology used in this study, including a literature study and a self-administered survey, that is, a web-based survey used to collect the respondents' answers to the questionnaire. The survey tool used was LimeSurvey. The Bureau of Market Research at UNISA completed the questions on the survey tool and administered the web survey on behalf of the researcher. The target population comprised private and public companies, as the holders of the prospecting rights. The total number of prospecting rights held by the target population amounted to 2 656. These 2 656 prospecting rights were held by 49 public companies and 1 117 private companies, which comprised the target population. This study used purposive, non-probability sampling and the sample selected for this study comprised companies with more than five prospecting rights each and with company registration numbers dating from the year 2004.

Chapter 6: Research results

This chapter presents the findings and data obtained from the survey.

Chapter 7: Conclusions and recommendations

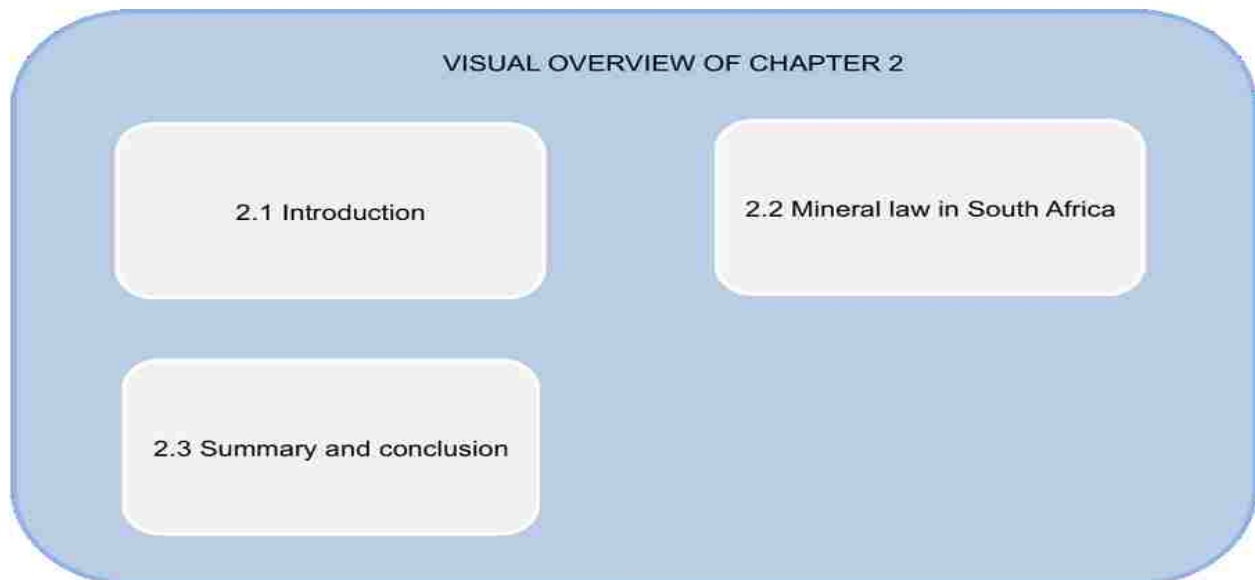
A final summary and conclusions are presented on the accounting and taxation practices of the junior exploration companies selected for the sample and which are prospecting for mineral deposits in South Africa. The chapter also identified areas for further study and highlights the limitations of the study.

CHAPTER 2

LITERATURE REVIEW: HISTORICAL OVERVIEW OF MINERAL RIGHTS IN SOUTH AFRICA

2.1. INTRODUCTION

South Africa has a mineral-based economy and the issue of mineral rights impacts on the welfare of the mining industry. Mineral law in South Africa originated when the Dutch colonised the Cape in 1652 and has continued to develop until today. With the coming to power of the ANC in 1994 a new era in respect of mineral rights dawned. The mineral rights policies in South Africa were consequently reviewed and the Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA) was promulgated in 2004. The aim of this chapter is to provide a perspective on the origin of the mining industry in South Africa in general. This study investigates junior exploration companies that are a component of the mining industry in South Africa. The historic overview shows how mineral policies of a country can influence exploration activities and therefore junior exploration companies. The chapter also describes the process, which according to the MPRDA, needs to be followed in order to obtain a prospecting right. The exploration phase starts when a junior exploration company obtains a prospecting right and it is at this stage that exploration expenditure are included in the scope of IFRS 6 (IASB, 2010a). The layout of this chapter is as follows:



2.2. MINERAL LAW IN SOUTH AFRICA

Mineral law in South Africa has developed over a period of more than three hundred years (Cawood & Minnitt, 1998:370). This period of three hundred years may be broken down into the following eras:



Figure 2.1: South Africa mineral law eras

Source: Own observation

2.2.1. Dutch era

The Dutch colonised the Cape in 1652 and the Roman-Dutch legal system became the law of the land (Cawood & Minnitt, 1998:370). However, as mining did not play an important role in Holland at that time, Dutch Law had no effect on mining law as such (Cawood & Minnitt 1998:370), and South Africa inherited the principle rule of property law from the Roman Common Law (Cawood & Minnitt, 1998:370). This principle stipulates that ownership of land extends to the heavens and down to the depths (Dale, 1979:3). Accordingly, minerals, as a fundamental part of the land, were the property of the owner of the land (Dale, 1979:3). During the Dutch era, mineral rights and the right to mine were regarded as the property of the owner of the land.

2.2.2. British era

In England the Roman law principle was altered to suit the English legal minds – a move away from the private ownership of minerals (Dale, 1979:44). England made use of the concept of nationalisation to move away from the concept of privately owned minerals and rights to minerals (Dale, 1979:71). In 1806 the Cape came under British rule although the Roman-Dutch legal system was still retained as the common law (Cawood & Minnitt, 1998:370). Levin and Handley (cited in Cawood & Minnitt, 1998:370) highlighted that the Cradock Proclamation of 1813 was the first major amendment to Roman-Dutch Law as it was practised in the Cape at the time. This proclamation continued the principle of the English law theory that reserves for the

Crown the right to mine precious stones, gold and silver (Dale, 1979:217). Section 4 of the Cradock Proclamation read as follows (Dale, 1979):

Government reserves no other right but those on mines of precious stones, gold or silver; as also right of making and repairing public roads, and raising material for the purpose on the premises: Other mines of iron, lead, copper, tin, coal, slate or limestone are to belong to the proprietor.

Accordingly, this proclamation gave to the government of the Cape Colony the right to mine precious stones, gold and silver and, having acquired this right, it was in a position to lease these rights to whomever it chose (Cawood & Minnitt, 1998:370). Despite the fact that the intention of the “right to mine” was not intended to influence the tenure of private mineral rights it may be seen as the first step away from private ownership of mineral rights.

2.2.3. Independent provincial states

Several independent provincial governments were established after the Great Trek into the interior in 1836 (Cawood & Minnitt, 1998:370). Each of these governments passed laws that set aside certain minerals to the state. The guiding philosophies of the law in each of the provinces can be summarised as follows:

2.2.3.1. Republic of Transvaal

The guiding philosophy of law in the Republic of Transvaal was to reserve the right to mine gold, silver and precious stones for the State (Dale, 1979:177). Article 1 of Law 1 of 1871 of Transvaal stated that (Dale, 1979): “het mijnregt op alle edelgeteenten en edele metalen behoort aan den Staat” – the right to mine precious stones and precious metals belongs to the State.

The Transvaal Republic then passed Law 1 of 1883 that reserved all the mineral rights and the right to mine precious stones and precious metals to the State (Dale, 1979:182). In section 2 of Law 1 of 1883 a deviation in the wording is obvious (Dale, 1979): “Het eigendom in en mijnregt op alle edelgesteenten en edelemetalen behoort aan den Staat ...” – precious stones and metal are the property of the State and, in addition, the right to mine precious stones and precious metals belongs to the State.

The policy section of Law 8 of 1885 was reworded with this rewording reintroducing the right to mine for precious stones and precious metals being reserved for the State only (Dale, 1979:185). The difference between the principles of mineral rights and the right to mine was re-established and the notion of private mineral rights was reintroduced.

The Transvaal Republic also introduced the proclaimed land class which allowed the State to grant surface rights permits for privately owned land to the mining companies (Cawood & Minnitt, 1998:370). In 1898 the Legislature saw fit to divide the legislation into the Gold Law 15 of 1898 and the Precious Stones Law 22 of 1898.

2.2.3.2. Orange Free State

The digging for precious metals and precious stones other than diamonds was dealt with in Chapter CXV of the Oranje Vrystaat (OVS) Wetboek (Orange Free State Lawbook), which was compiled in 1892 (Dale, 1979:203). This chapter followed the early Republic of Transvaal Legislation (Law 1 of 1883 as amended) (Dale, 1979:204) while Chapter CXVI of the OVS Wetboek dealt specifically with diamonds – with the discovery of diamonds the State President had the option to purchase the farm on which the diamonds had been discovered or to supervise the diggings (Dale, 1979:204). The Orange Free State Government followed the “right to mine” principle by reserving the right to mine gold, silver and precious stones for the State.

2.2.3.3. Natal

The first reference to mining in Natal appears in a private law of 26th September 1864 in terms of which the Natal Coal Company was authorised to purchase and take on lease land for mining purposes (Dale, 1979:208). In 1867, in terms of Law 15 of 1867, the government introduced the category of Trust Land which was termed the Natal Native Trust (Dale, 1979:208). This trust was empowered to grant the mineral leases of mines and minerals under its control with the approval of the Lieutenant Governor (Dale, 1979:209). The basic philosophy underlying the Natal Mining Legislation was that the right to mine all minerals was reserved to the State (Dale, 1979:209). A consolidated law with regards to mining emerged as Law 17 of 1887 with Section 4 of the Law reading as follows (Dale, 1979):

The right of mining for and disposing of all gold, precious stones and precious metals, and all other minerals in the Colony of Natal, is hereby vested in the Crown for the purposes of and subject to the provisions of this Law.

Thus, Natal followed the “right to mine” principle of all minerals, including coal, to the State and this was retained in later laws passed in Natal.

2.2.3.4. Cape

Dale (1979:216) mentions that the earliest stipulation dealing with the removal of minerals in the Cape that he was able to find was a Placaat of 25th March 1735, in terms of which the removal of clay from behind the castle at the Cape was prohibited as a result of the damage such removal was causing to the area. As mentioned in section 2.2.2, the Cradock Proclamation of 1813 reserved the right to mine precious stones, gold and silver to the government. However, no laws referring to mining appeared until the Mining Leases Act 10 of 1865 which governed the leasing and working of minerals in Namaqualand (Dale, 1979:217). Rent and royalties were imposed on leased Crown lands and a minimum quantity of ore had to be mined. However, the Mining Leases Act 10 of 1865 stated that no lease would award rights to gold, silver, platinum or precious stones.

The Precious Stones and Minerals Mining Act 19 of 1883 was the first law on mining to be passed in the Cape (Dale, 1979:218). This Precious Stones and Minerals Mining Act 19 of 1883 allowed the taking out of prospecting licences for precious stones, gold, silver or platinum on either Crown land or on private land where the precious stones or minerals were reserved to the Crown, without the consent of the owner (Dale, 1979:219). Totally new legislation appeared as the Precious Minerals Act 31 of 1898, in terms of which prospecting licences were obtainable for both Crown and private land subject to the approval of the owner (Dale, 1979:223). Thus, the Cape Government followed the “right to mine” principle by reserving the right to mine gold, silver and precious stones to the State although the owner of private land on which the precious metals had been found was able to obtain the initial mining lease and his consent was required if the lease were to be granted to a third party.

2.2.4. Union era

With the unification of the separate, independent provincial states into the Union of South Africa in 1910, an attempt was made to consolidate the legal system. The first statute to influence the ownership of mineral rights in this consolidation process was the Land Settlement Act of 1912 (Cawood & Minnitt, 1998:371) in terms of which all mineral rights, and not only the right to mine, were reserved to the state (Cawood & Minnitt, 1998:371). The Land Settlement Amendment Act 23 of 1917 changed this in 1917, as this Act stipulated that the rights to minerals were passed

on with the land (Dale, 1979:227). Accordingly, with this 1917 Act, the mineral rights reverted to the landowner. This was clearly a major step towards the privatisation of the ownership of mineral rights.

The state-owned vast tracts of land and, although it disposed of some of this land to individuals, it retained the rights to the minerals on this land with this land becoming known as Alienated state Land (Cawood & Minnitt, 1998:371). The Reserved Minerals Development Act 55 of 1925 allowed the owners of Alienated State Land or their nominees the exclusive right both to prospect and to mine on their land (Dale, 1979:229). However, if a mine were established on Alienated State Land then the state was entitled to royalty payments (Cawood & Minnitt, 1998:371). In addition, although the landowners of Alienated State Land had the exclusive right to prospect and to mine on their land, the government had the power to appoint a third party to prospect on their behalf if the landowner did not take advantage of his/her right either to prospect or to mine.

From a minerals rights ownership point of view the next important piece of legislation was the Base Minerals Development Act 39 of 1942 (Cawood & Minnitt, 1998:371). This Act gave the state the right to intervene if private land was not properly prospected and to give the exclusive right to prospect such land to a third party if the state considered this to be of national interest (Dale, 1979:234). The Natural Oil Act 46 of 1942 gave the state the exclusive right to prospect and to mine for oil (Cawood & Minnitt, 1998:371). In 1948, for the first time, an Atomic Energy Act appeared in the form of Act 35 of 1948. This Act vested in the state the sole right to prospect or to mine for prescribed materials of the uranium family (Dale, 1979:235). The shift towards state control continued when the Land Settlement Act 21 of 1956 once again reverted to the system in terms of which the mineral rights on land granted under the Act were vested in the state (Dale, 1979:236). The Union era highlights the move towards state control of both the mineral rights and the mining industry in South Africa.

2.2.5. Republic era

The formation of the Republic of South Africa in 1961 heralded the next stage of constitutional development in South Africa (Cawood & Minnitt, 1998:371). Over the years mineral rights law has developed in such a way that the mineral right or right to mine depended on both the type of mineral and the type of land in which the minerals were found (Nel, 1994:129). Precious stones were governed by the Precious Stones Act 73 of 1964 (Nel, 1994:129). The underlying principle

of this Precious Stones Act 73 of 1964 is that the right both to mine for and to dispose of precious stones is vested in the state (Dale, 1979:238). It is obvious that all mining areas in respect of precious stones were under the control of the Minister of Mines and his department.

The Mining Rights Act 20 of 1967 was an attempt to consolidate the excess of legislation pertaining to minerals into a single Act (Dale, 1979:240). Accordingly, the various types of mineral, including precious metals, base minerals, reserved minerals and natural oil, were all governed by this Act (Dale, 1979:240). The right both to prospect and to mine for natural oil and precious metals and to dispose of these minerals vested in the state with the right both to prospect and to mine for and to dispose of base minerals being vested in the holder of the right to base minerals.

Mineral rights were again affected by the Mineral Laws Supplementary Act 10 of 1975 (Cawood & Minnitt, 1998:371). This Act provided for processes in terms of which any person or company was able to obtain mineral rights over land where the private mineral rights were separated from the land itself or where the mineral rights were held in undivided shares and it was not possible to obtain permission to exploit the mineral rights readily (Cawood & Minnitt, 1998:371). This, in turn, also prevented the further fragmentation of private mineral rights by testamentary succession without state approval (Cawood & Minnitt, 1998:371).

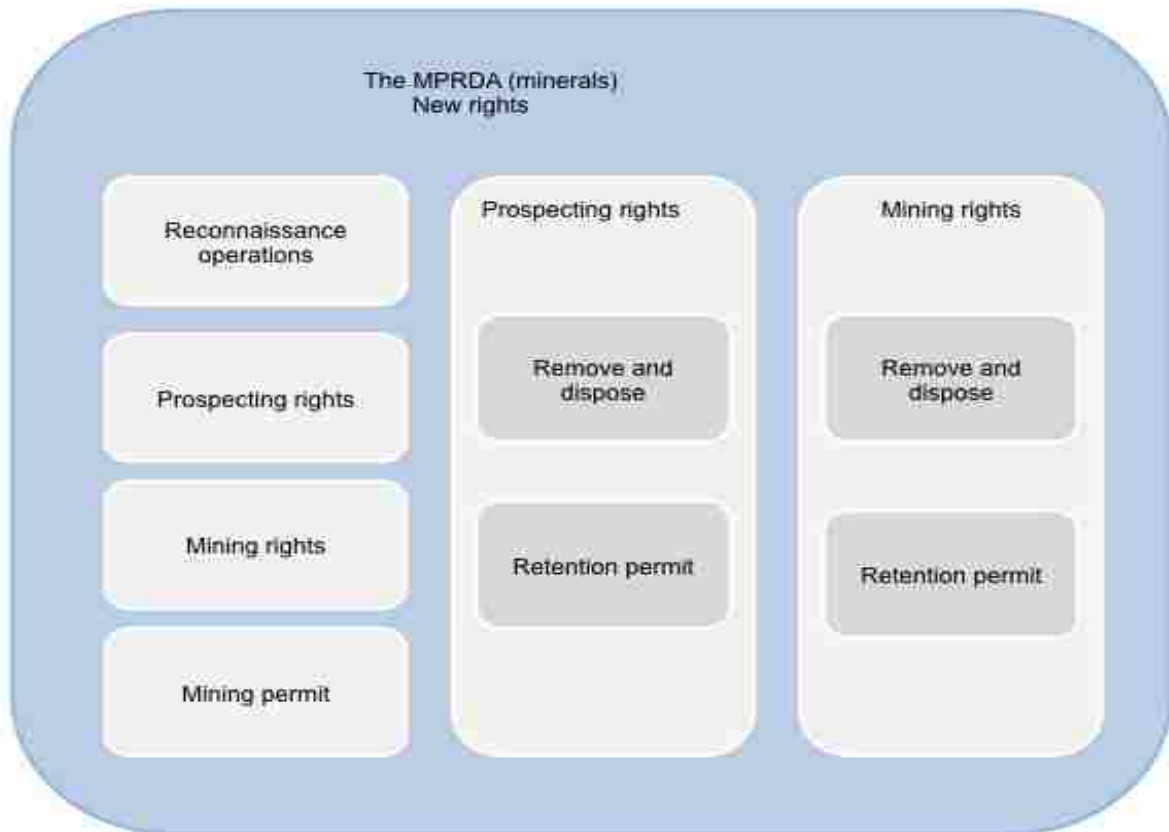
With the passing of the Minerals Act 50 of 1991 in 1992, the “right to mine” principle that had been the legal foundation of mineral exploitation in South Africa expired (Cawood & Minnitt, 1998:371). This Act provided for the termination of the various classes of land and categories of mineral rights that had come about as a result of the disjointed legal developments in the four provinces (Nel, 1994:165). The Act also provided for the transfer to the minerals right owner of the right to prospect for and to mine those minerals that had previously been reserved exclusively for the state and all proclaimed land was deproclaimed (Cawood & Minnitt, 1998:371–372). According to the Minerals Act 50 of 1991 it was still incumbent on the mineral rights holder to apply for a prospecting permit from the regional director of the Department of Mineral and Energy Affairs (DMEA) (Nel, 1994:169). The most interesting feature of the Minerals Act 50 of 1991 is probably section 64, which allowed for the disposal of state-owned mineral rights to the private sector (Cawood & Minnitt, 1998:372). It would appear that the cabinet of that time were aware of the ANC’s views on mineral policies

and the cabinet's aim with section 64 of the Minerals Act 50 of 1991 was to ensure that government involvement in the mining industry was reduced in the future.

2.2.6. Present day South Africa

The publication of the Reconstruction and Development Programme (RDP) by the ANC in February 1994 marked the commencement of the revision of the minerals policy in South Africa (Cawood & Minnitt, 1998: 374). The Green Paper for public discussion on a Mineral and Mining Policy for South Africa was released on 3 February 1998 (Cawood & Minnitt, 1998:375). This Green Paper gave a clear indication of intent with regard to mineral rights ownership in South Africa. Finally, the MPRDA was promulgated on 1 May 2004 and it changed the entire mineral law system (Badenhorst, 2003:333). The MPRDA should be read in conjunction with the Broad-based Socio-Economic Empowerment Charter for the South African Mining Industry (Mining Charter) (DMR, 2010). The researcher would like to highlight the two following objectives of the MPRDA; namely, the state has the right to exercise, firstly, sovereignty and, secondly, custodianship of the nation's mineral and petroleum resources. The MPRDA is divided into two main categories, namely, minerals and petroleum. However, this study refers to minerals only. Table 2.1 sets out the main focus of the MPRDA regarding new mineral rights.

Table 2.1: Main focus of MPRDA regarding new mineral rights



Source: Coertse (2005:18)

The essence of the MPRDA lies in prospecting rights, mining rights, permission to remove and dispose of minerals and retention permits (Coertse, 2005:18). As per the definition of prospecting in chapter 1 of the MPRDA, as soon as the surface of the earth on which prospecting is taking place is disturbed it becomes necessary to apply for a prospecting right in the prescribed manner on the prescribed forms (Coertse, 2005:18). This chapter focuses on the process to be followed to obtain a prospecting right as junior exploration companies are only involved in exploration activities and therefore will not be in possession of a mining right.

In terms of section 16 of the MPRDA, any person who wishes to apply to the Minister of Mineral and Energy Affairs for a prospecting right must lodge the application in the prescribed manner at the office of the regional manager in whose region the land is situated together with the prescribed, non-refundable application fee. It is incumbent on this regional manager to accept the application if no other person holds a prospecting right, mining right, mining permit or retention permit for the same mineral and land. If the application is accepted the regional

manager must, within 14 days from the date of acceptance, notify the applicant in writing that the applicant must submit an environmental management plan and also notify in writing and consult with the landowner or lawful occupier. The applicant must then submit the outcome of this consultation within 30 days from date of notice to the regional manager. The regional manager will then forward the application to the Minister for consideration. The Minister may, having regard to the type of mineral concerned and the extent of the proposed prospecting project, request the applicant to give effect to the objective referred to in section 2(d) of the MPRDA. This objective involves substantially expanding opportunities for historically disadvantaged persons, including women, to share in the wealth of the country. In terms of section 41(1), an applicant for a prospecting right must make the prescribed financial provision for the rehabilitation or management of negative environmental impacts before the minister will approve the environmental management plan. The granting of the prospecting right becomes effective on the date on which the environmental management plan is approved. It is clear from the above requirements that a considerable time could lapse and expenditure incurred before a prospecting right is granted. It is important for junior exploration companies to know when the prospecting permit is granted as it is only from this stage onwards that exploration expenditure can be accounted for in terms of IFRS 6 (IASB, 2010a).

The prospecting right may not exceed five years and it may be renewed once for a period not exceeding three years (Coertse, 2005:18). The holder of the prospecting right has the exclusive right to apply for and be granted a renewal of the prospecting permit, a mining right and the right to remove and dispose of any mineral to which such rights relate (Coertse, 2005:18). The period of the prospecting right could influence the impairment test of the exploration and evaluation asset in accordance with IFRS 6 (IASB, 2010a).

In August 2010 the government imposed a six-month moratorium on new prospecting rights and announced that the MPRDA would be revised (Crotty, 2010). This announcement did not give a timeline regarding this revision of the MPRDA.

2.3. SUMMARY AND CONCLUSION

South Africa has a mineral-based economy and both the issue of mineral rights and mineral law have developed over a period of more than three hundred years. The issues relating to the private ownership of the right to mine on one's own land and the control of the right to mine and the mining industry by the state are evident throughout the period. With the passing of the

Minerals Act 50 of 1991 the “right to mine” principle expired with this Act providing for the transfer to the mineral rights owner of the right to prospect for and to mine those minerals that had previously been reserved exclusively for the state. The MPRDA was promulgated on 1 May 2004 and is based on the Freedom Charter of 1955 of the ANC, which had highlighted the fact that the people shall share in the mineral wealth of the country. The Government’s long-term goal is for all mineral rights to vest in the state on behalf of the people. Government also promotes minerals development by applying the “use it or lose it principle”. The new mineral policy in South Africa allows the state to grant prospecting rights to various newcomers and, in this way, ensures that the mineral wealth of South Africa is properly developed. In addition, one of the consequences of this new policy is that a large number of junior exploration companies and investors applied for prospecting rights.

The following chapter discusses the accounting treatment and practices of pre-exploration expenditure in terms of the Framework (IASB, 2010a) and other accounting standards. The accounting treatment of exploration expenditure is included in the scope of IFRS 6 (IASB, 2010a); therefore the main features of IFRS 6 (IASB, 2010a) are investigated. IFRS 6 (IASB, 2010a) permits an entity to develop its own accounting policy for its exploration and evaluation assets; hence, the various accounting practices for exploration and evaluation costs are also examined in the next chapter.

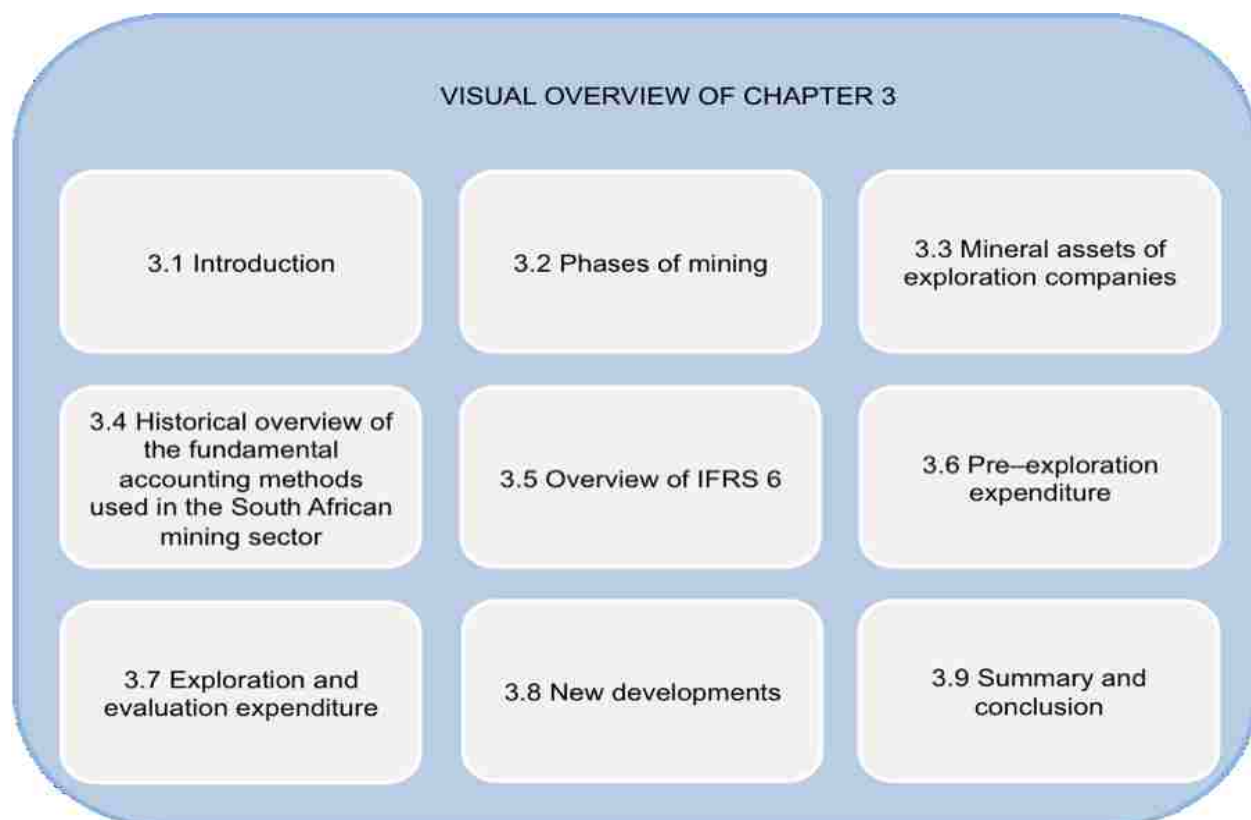
CHAPTER 3

LITERATURE REVIEW: ACCOUNTING PRACTICES

3.1. INTRODUCTION

The lack of uniformity and acceptable accounting practices in the extractive industries has been recognised over a long period (Luther, 1996:67). Even with the issue of IFRS 6 (IASB, 2010a), *Exploration for and evaluation of mineral resources*, there are still various accounting interpretations and practices relating to the accounting for exploration and evaluation expenditure.

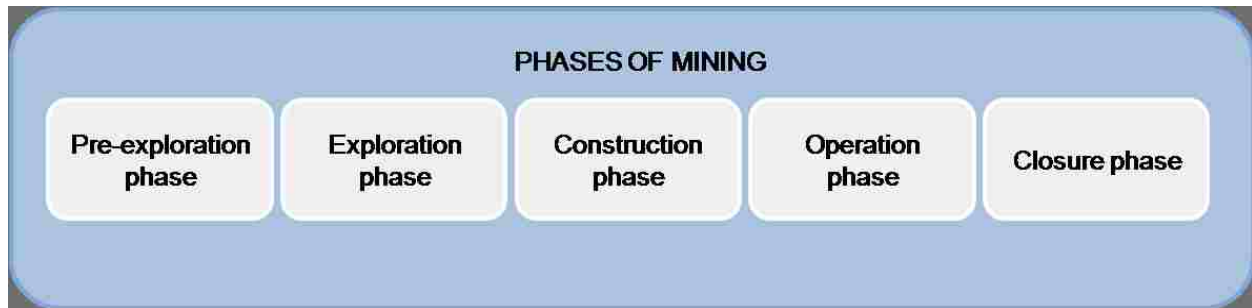
The aim of this chapter is to investigate the accounting practices of pre-exploration and exploration expenditure by junior exploration companies. The accounting treatment of pre-exploration expenditure in terms of the Framework (IASB, 2010a) and other accounting standards are discussed. The accounting treatment of exploration expenditure is included in the scope of IFRS 6 (IASB, 2010a); therefore the main features of IFRS 6 (IASB, 2010a) are investigated in this chapter. The layout of this chapter is as follows:



3.2. PHASES OF MINING

There are various phases of mining, but junior exploration companies are only involved in the pre-exploration and exploration phase. Table 3.1 illustrates the different phases of mining.

Table 3.1: Phases of mining



Source: Own observation

The pre-exploration phase refers to all expenditure incurred before an entity has obtained the legal right to explore a specific area, therefore all expenditure incurred by a junior exploration company before a prospecting right is obtained classifies as pre-exploration expenditure. The exploration phase begins when the prospecting right is obtained and ends upon completion of a feasibility study (KPMG, 2009). The mine construction phase generally begins after completion of a feasibility study and ends upon the commencement of production (KPMG, 2009). The operation phase commences with the production of minerals from the mining of the mineral reserves. The closure phase commences with the termination of production and includes activities such as decommissioning and dismantling equipment, restoring the mine site as a result of damage caused to the environment during the development of a mine and from ongoing mining activities, and ongoing care and maintenance of closed mines (KPMG, 2009).

IFRS 6 (IASB, 2010a) deals specifically with the expenditure relating to the exploration phase. The recognition and measurement of pre-exploration expenditure are discussed in section 3.6 while the requirements of IFRS 6 (IASB, 2010a) on exploration and evaluation expenditure is discussed in section 3.7. The construction, operation and closure phases of mining are not dealt with in IFRS 6 (IASB, 2010a) and, thus, mining companies shall apply the Framework (IASB, 2010a), other IFRSs (IASB, 2010a) and IASs (IASB, 2010a) issued by the IASB to transactions, assets and liabilities incurred during these latter phases.

3.3. MINERAL ASSETS OF EXPLORATION COMPANIES

Before the accounting practices of junior exploration companies are discussed it is important to understand the underlying asset that is created by doing exploration activities. As per the presentation by Davel (2009), the main asset of mining companies initially comprises the legal rights to explore an area with these exploration activities then resulting in knowledge and, ultimately, mineral reserves being identified. Accordingly, the main asset of junior exploration companies are the prospecting rights that will develop from the knowledge that were obtained from surveys, boreholes, trenches, pits and other prospecting work about the mineral reserves and resources into the production of mineral reserves. The results obtained from the exploration phase will indicate whether the mineral resources are inferred, indicated or measured and it is from these results that a company will be able to classify the mineral reserve as either probable or proven.

The South African Code for the Reporting of Mineral Asset Valuation (SAMVAL Code) (SAMCODE, 2008) sets out minimum standards and guidelines for the public reporting of mineral asset valuations in South Africa. This code was drawn up under the joint auspices of the Southern African Institute of Mining and Metallurgy (SAIMM) and the Geological Society of South Africa (GSSA). According to the SAMVAL code (SAMCODE, 2008) the term “mineral resources” may be defined as

A concentration or occurrence of material of economic interest in or on the earth’s crust in such form, quality and quantity that there are reasonable and realistic prospects for eventual economic extraction. The location, quantity, grade, continuity and other geological characteristics of a mineral resource are known, or estimated from specific evidence, sampling and knowledge interpreted from an appropriately constrained and portrayed geological model. Mineral resources are subdivided, and must be so reported, in order of increasing confidence in respect of geoscientific evidence, into inferred, indicated and measured categories (SAMCODE, 2008).

According to paragraph 22 of the South African Code for the Reporting of Exploration Results, Mineral Resources and Mineral Reserve (SAMREC Code) (SAMCODE, 2007) the term “inferred mineral resources” is defined as “... that part of a mineral resource for which volume or tonnage, grade and mineral content can be estimated with only a low level of confidence...”. An inferred mineral resource is characterised by the lowest level of confidence.

Paragraph 24 of the SAMREC Code (SAMCODE, 2007) defines indicated mineral resources as “... that part of a mineral resource for which tonnage, densities, shape, physical characteristics, grade and mineral content can be estimated with a reasonable level of confidence ...”. Indicated mineral resources have a higher level of confidence than inferred mineral resources but a lower level of confidence than measured mineral resources.

Paragraph 25 of the SAMREC Code (SAMCODE, 2007) defines measured mineral resources as “... that part of a mineral resource for which tonnage, densities, shape, physical characteristics, grade and mineral content can be estimated with a high level of confidence...”. Measured mineral resources indicate the highest level of confidence.

According to the SAMVAL Code (SAMCODE, 2008) the term “mineral reserves” may be defined as

The economically mineable material derived from a measured or indicated mineral resource or both. It includes diluting materials and allows for losses that are expected to occur when the material is mined. Appropriate assessments to a minimum of a Pre-Feasibility Study for a project, or a Life of Mine Plan for an operation, must have been carried out, including consideration of, and modification by, realistically assumed mining, metallurgical, economic marketing, legal environmental, social and governmental factors. Where the term ‘ore reserve’ is used, this is synonymous with the term “mineral reserve”.

A reserve refers to the economically mineable material in the mineral resource. Paragraph 33 of the SAMREC Code (SAMCODE, 2007) defines a probable mineral reserve as “... the economically mineable material derived from a measured or indicated mineral resource or both. It is estimated with a lower level of confidence than a proved mineral reserve ...” while paragraph 34 of the SAMREC Code (SAMCODE, 2007) defines proved mineral reserve as “... the economically mineable material derived from a measured mineral resource. It is estimated with a high level of confidence ...”. Thus, according to the SAMREC Code, when a mineral reserve is classified as a proven mineral reserve such a mineral reserve represents the highest level of confidence obtainable. Figure 3.1 illustrates the relationship between the exploration results, mineral resources and mineral reserves.

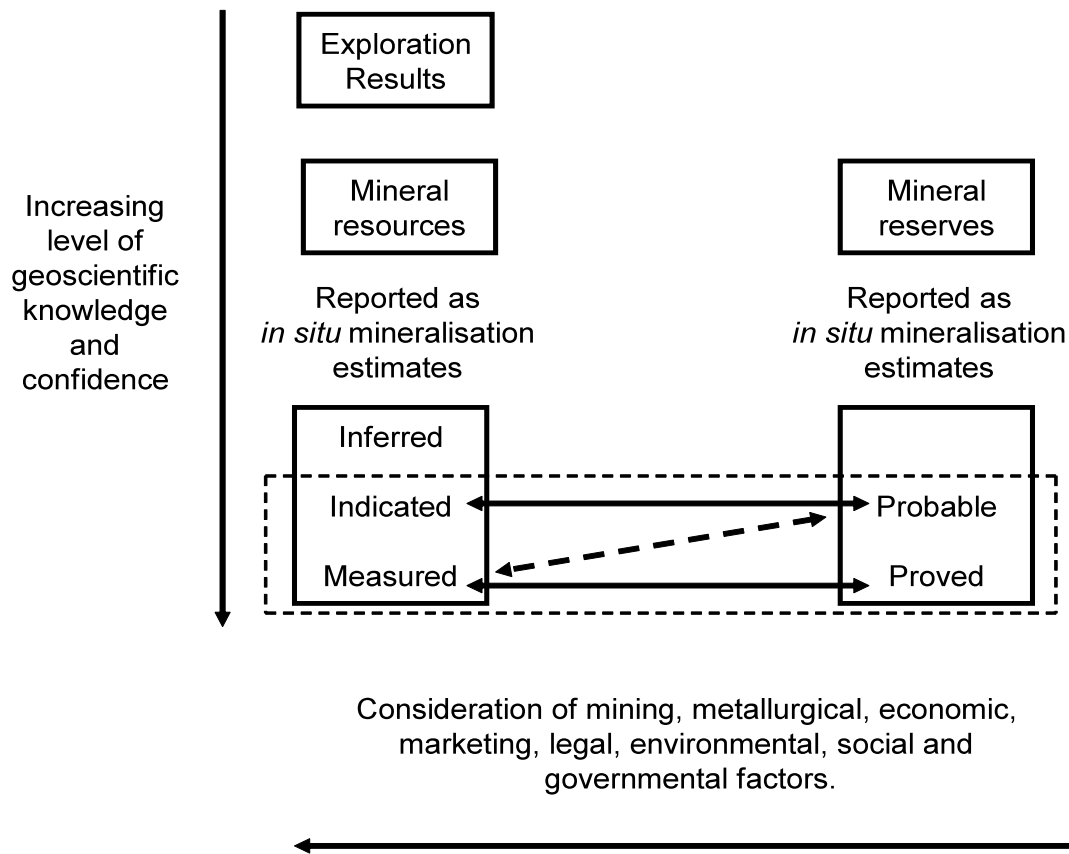


Figure 3.1: Relationship between exploration results, mineral resources and mineral reserves

Source: Paragraph. 12 the SAMREC Code (SAMCODE, 2007)

According to paragraph 21 of the SAMVAL Code (SAMCODE, 2008), the three generally accepted approaches to mineral asset valuation include the cash flow approach, market approach and the cost approach. Paragraph 21 of the SAMVAL Code (SAMCODE, 2008) defines these approaches as follows:

- The Cash Flow Approach relies on the 'value-in-use' principle and requires a determination of the present value of future cash flows over the useful life of the Mineral Asset.
- The Market Approach relies on the principle of 'willing buyer, willing seller' and requires that the amount obtainable from the sale of the Mineral Asset is determined as if an arm's-length transaction had occurred.
- The Cost Approach relies on historical and/or future amounts spent or to be spent on the Mineral Asset.

Both the cash flow and the market approaches use various estimates and assumptions in order to value mineral assets.

As discussed above, the main asset of an exploration company evolves over time and, ultimately, the exploration activities will confirm probable and/or proved mineral reserves. In addition, as discussed in section 3.5.3, after recognition, exploration and evaluation assets may be measured using either the cost model or the revaluation model. The revaluation model depends on the classification of the assets.

As per the presentation by Davel (2009), although the cost model is verifiable, it has limited relevance to the users of financial statements, as there is no connection between the historical exploration costs incurred and the future cash flows that will be generated from the mining property. The cost model is also cost effective and not time consuming. In order to obtain the fair value of the main asset of the exploration company various subjective assumptions and estimates are required. As per the discussion above, various assumptions are used both to classify and to value mineral resources and reserves. It would, however, take both time and effort to carry out these valuations and the process would require input from various professional people. Exploration companies would have to consider the cost of obtaining these values and whether these values would be meaningful to the users of the financial statements.

As discussed in section 3.5.6 the disclosure requirements of IFRS 6 (IASB, 2010a) are limited. Accordingly, a comprehensive disclosure of the main assets of exploration companies is important as this will enable the users of the financial statements to make their own assumptions and estimates about the value of the underlying main asset of exploration companies.

3.4. HISTORICAL OVERVIEW OF THE FUNDAMENTAL ACCOUNTING METHODS USED IN THE SOUTH AFRICAN MINING SECTOR

Before the promulgation of the MPRDA, Jourdan (cited in Cawood & Minnitt, 1998:373) was of the opinion that the large mining houses held almost all mineral rights. As a result, these mining houses carried out almost all exploration activities in South Africa. To provide background information of the previous accounting practices that influenced the accounting for exploration and evaluation expenditure are discussed. The South African Institute of Chartered Accountants (SAICA) issued a guideline on the accounting and reporting practices in the mining industry (SAICA, 1995). This methodology contained in the guideline is based on the basic principle that

mines have a finite life (SAICA, 1995:1). When all the mineral reserves have been extracted from a specific area the company will close down and, therefore, mineral reserves may be regarded as a “wasting asset” (Luther, 1996:68). The guideline prescribed the accounting methodology called the “appropriation method” (Davel, 2005). “This methodology simulates cash flow accounting and is based on the argument that mines have a finite life and that the retention of funds to replace the mining facility is pointless” (Davel, 2005). For this reason, capital expenditure is regarded as irretrievable and no depreciation is provided (Luther, 1996:79). The appropriation method was more commonly used than any other method and has the same result as when all capital expenditure is expensed (SAICA, 1995:1). Accordingly, all pre-exploration and exploration expenditure incurred was immediately expensed in the financial statements.

Another method used by various mining companies was the “amortisation method” (SAICA, 1995:1). This method intended to match costs and revenues by the amortisation of the capitalised cost of mining assets, which included the costs of exploration and evaluation, infrastructure, development costs, pre-production costs and capitalised interest, over the estimated life of the mining operation (SAICA, 1995:3). This method was regarded as appropriate for mining companies that were likely to continue mining or exploiting new mineral resources over an extended period of time (SAICA, 1995:3).

3.5. OVERVIEW OF IFRS 6

Exploration and evaluation activities of mineral resources are excluded from the scope of IAS 38 (IASB, 2010a), *Intangible assets*, as well as mineral rights and mineral resources are excluded from the scope of IAS 16 (IASB, 2010a), *Property, plant and equipment*. Consequently, according to IAS 1 (IASB, 2010a), *Presentation of financial statements*, paragraph 17(a), management will consider the guidance in IAS 8 (IASB, 2010a), *Accounting policies, changes in accounting estimates and errors*, in the absence of an IFRS that specifically applies to an item in order to determine a policy.

IFRS 6 (IASB, 2010a), *Exploration for and evaluation of mineral resources*, was developed as an interim standard to allow entities adopting IFRSs to continue to apply their existing accounting policies for these expenditure (IFRS Foundation, 2010). The IASB issued IFRS 6 (IASB, 2010a) in December 2004. IFRS 6 (IASB, 2010a) is applicable for annual periods

beginning on or after 1 January 2006. Earlier application is encouraged and when an entity applies this IFRS for a period beginning before 1 January 2006, the entity discloses this fact.

An overview of the main features of IFRS 6 (IASB, 2010a) are presented below.

3.5.1. Objective

The main objective of IFRS 6 (IASB, 2010a) is to indicate the financial reporting for the exploration for and evaluation of mineral resources. The IFRS specifically requires limited improvements to existing accounting practices (IFRS 6.IN4), the assessment of exploration and evaluation assets for impairment in accordance with IAS 36 (IASB, 2010a), *Impairment of assets* and disclosure that will identify and explain amounts in the financial statements arising from the exploration and evaluation of mineral resources.

3.5.2. Scope

IFRS 6 (IASB, 2010a) applies only to exploration and evaluation expenditure incurred after the entity has obtained the legal rights to explore a specific area but the IFRS does not apply after the technical feasibility and commercial viability of the mineral resources are confirmable (IASB, 2010a). IFRS 6 (IASB, 2010a) indicates that expenditure relating to the development of mineral resources, therefore from the construction phase onwards, is accounted for in accordance with the Framework (IASB, 2010a) and IAS 38 (IASB, 2010a).

3.5.3. Recognition and measurement of exploration and evaluation assets

Under IFRS 6 (IASB, 2010a), a mining entity has to determine an accounting policy specifying which expenditures on exploration and evaluation activities will be recorded as exploration and evaluation assets and then apply that policy consistently (PWC, 2007) (refer section 3.7.1). Exploration and evaluation assets are exploration and evaluation expenditure recognised as an asset in accordance with the reporting entity's accounting policy (Epstein & Jermakowicz, 2009). IFRS 6 (IASB, 2010a) stipulates that an entity shall apply paragraph 10 of IAS 8 (IASB, 2010a), and temporarily exempts entities from paragraphs 11 and 12 of IAS 8 (IASB, 2010a). Accordingly, an entity can disregard the requirements of the Framework (IASB, 2010a) and also the pronouncements issued by other standard-setters, under an exemption from the requirements of paragraphs 11 and 12 of IAS 8 (PWC, 2007). However, paragraph 10 of IAS 8 (IASB, 2010a) stipulates that the policy must still be relevant and reliable. As a result of IFRS 6 (IASB, 2010a) a junior exploration company can at one extreme decide to recognise all

exploration and evaluation expenditure as an asset even if the outcome is highly uncertain (PWC, 2007). At the other extreme, a junior exploration company can decide to expense all exploration and evaluation expenditure (PWC, 2007). There are a variety of policies that can be accepted between these two extremes (PWC, 2007). When an exploration and evaluation asset is recognised, paragraph 8 of IFRS 6 (IASB, 2010a) specifies that the measurement of the exploration and evaluation assets at date of recognition be at cost.

IFRS 6 (IASB, 2010a) requires an entity to classify separately each exploration and evaluation asset as tangible or intangible based on the nature of the asset (KPMG, 2005) (refer section 3.7.2). The classification of the exploration and evaluation asset is the basis for accounting policy choices for both the measurement of the assets after recognition and for disclosure purposes (KPMG, 2005). Paragraph 12 of IFRS 6 (IASB, 2010a) stipulates that, after recognition, exploration and evaluation assets may be measured in accordance with either the cost model or the revaluation model (refer to section 3.7.4). The revaluation model followed depends on the classification of the assets as tangible or intangible. The exploration and evaluation assets classified as tangible follow the revaluation model requirements of IAS 16 (IASB, 2010a) and intangible follow the requirements of IAS 38 (IASB, 2010a) (refer to section 3.7.4.2).

In many jurisdictions mining companies are faced with legal or regulatory obligations for mine closure and rehabilitation activities (KPMG, 2009). IFRS 6 (IASB, 2010a) stipulates that any obligation for removal or restoration that arises as a consequence of having undertaken exploration for and evaluation of mineral resources shall be accounted for in accordance with IAS 37 (IASB, 2010), *Provisions, contingent liabilities and contingent assets*, (refer to section 3.7.3).

3.5.4. Presentation

In terms of paragraph 15 of IFRS 6 (IASB, 2010a), exploration and evaluation assets are classified according to their nature, tangible or intangible, and the classification is applied consistently.

Paragraph 17 of IFRS 6 (IASB, 2010a) states that, once the technical feasibility and commercial viability of the mineral resources are confirmable, then exploration and evaluation assets are assessed for impairment (refer to section 3.5.5) and are no longer classified as exploration and

evaluation assets. Exploration and evaluation assets will then be reclassified as either tangible or intangible development assets (KPMG, 2005).

3.5.5. Impairment

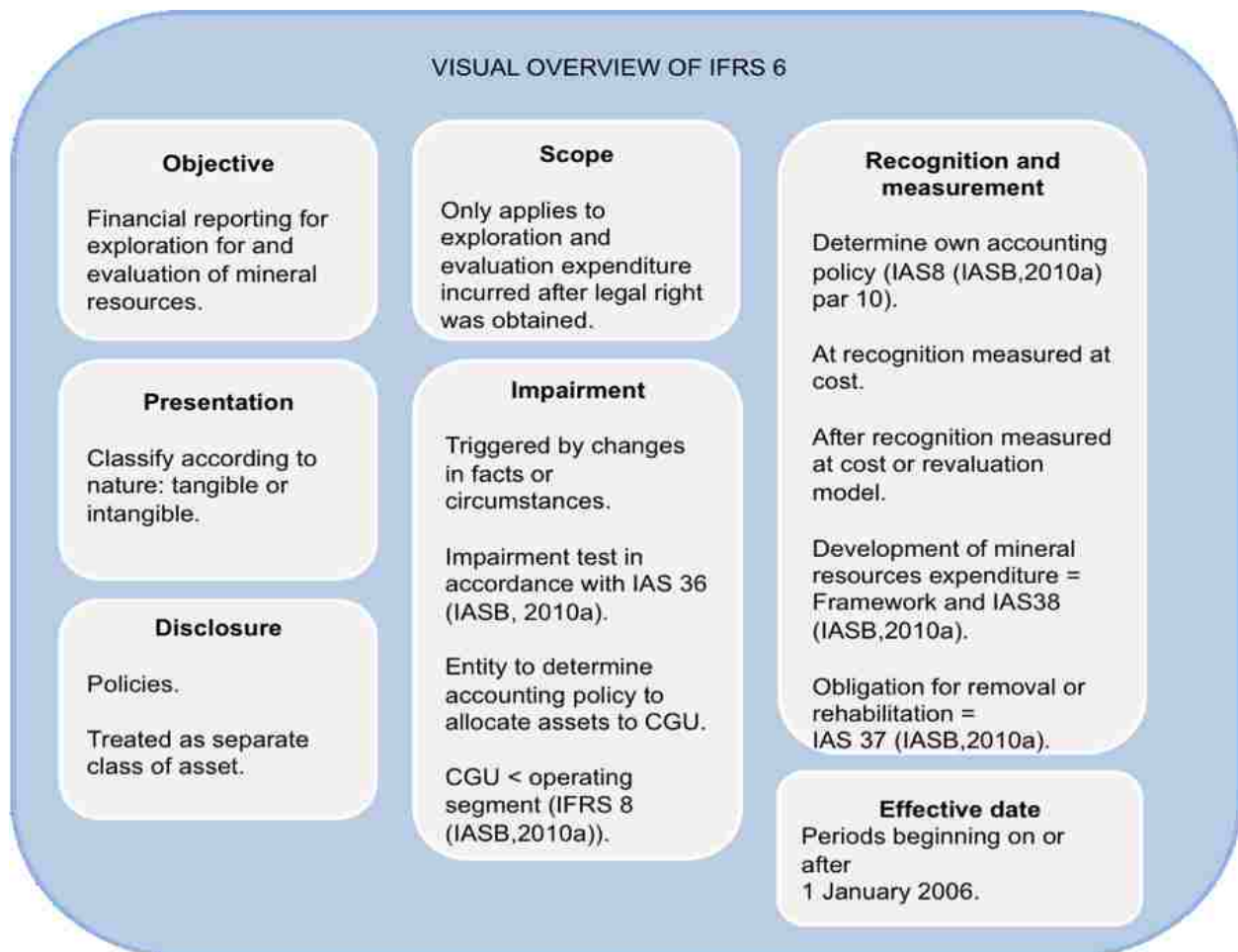
According to paragraph 18 of IFRS 6 (IASB, 2010a) the assessment of the impairment of exploration and evaluation assets should be triggered by changes in facts and circumstances. Once a change in facts and circumstances has been identified, then an entity performs an impairment test in accordance with IAS 36 (IASB, 2010a) (refer to section 3.7.5). Any impairment loss is recognised as an expense in accordance with IAS 36 (IASB, 2010a).

In terms of paragraph 21 of IFRS 6 (IASB, 2010a) an entity determines an accounting policy for allocating exploration and evaluation assets to either cash-generating units (CGU) or groups for the purpose of assessing such assets for impairment. This policy is aimed at specifying the level at which exploration and evaluation assets are assessed for impairment. Paragraph 21 of IFRS 6 (IASB, 2010a) also stipulates that each cash-generating unit or group to which exploration and evaluation assets were allocated shall not be larger than an operating segment determined in accordance with IFRS 8 (IASB, 2010a), *Operating segments*.

3.5.6. Disclosure

In terms of paragraph 23 of IFRS 6 (IASB, 2010a), an entity discloses its accounting policies for exploration and evaluation expenditure, including the recognition of exploration and evaluation assets. It also discloses the amounts of assets, liabilities, income and expenses, and operating and investing cash flows arising from the exploration and evaluation of mineral resources. Exploration and evaluation assets are treated as a separate class of asset. IFRS 6 (IASB, 2010a) requires the disclosures by either IAS 16 (IASB, 2010a) or IAS 38 (IASB, 2010a) to be made consistent with how the assets are classified. Section 3.5.7 provides a visual overview of IFRS 6 (IASB, 2010a).

3.5.7. Visual overview of IFRS 6



3.6. PRE-EXPLORATION EXPENDITURE

With the change in the mineral policy of South Africa (see section 2.2.6) the opportunity for new role players to enter the extractive industry in South Africa increased significantly. This led to an increase in the number of junior exploration companies exploring for mineral resources in order either to establish a mine or in the hope to locating remunerative mineral deposits with the objective of selling the mineral rights at a profit. Activities prior to the possession of a prospecting right are effectively pre-exploration (KPMG, 2005). IFRS 6 (IASB, 2010a) clarifies that any expenditure incurred before an entity has obtained the legal rights to explore in a specific area do not constitute exploration and evaluation expenditure and, consequently, such expenditure falls outside the scope of IFRS 6 (IASB, 2010a). This implies that companies would need to possess some form of legal right over the area to be explored before the relevant costs may be capitalised (Williamson, 2005b: 64). It is important to determine the exact date on which an entity acquired the legal right to explore an area. As discussed in section 2.2.6 the Mineral

and Petroleum Resources Development Act 28 of 2002 (MPRDA) stipulates that the application for a prospecting right becomes effective only on the date at which the environmental management plan is approved. The IASB noted that the appropriate accounting treatment of pre-exploration expenses can be obtained from the Framework, definitions of assets and expenses, and by applying the principles of asset recognition as contained in IAS 16 and IAS 38 (KPMG, 2005).

3.6.1. The Framework

As discussed above the appropriate accounting treatment of pre-exploration expenditure can be obtained from the definitions of assets and expenses included in the Framework (IASB, 2010a). Paragraph 49(a) of the Framework (IASB, 2010a) defines an asset as a resource which is controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity in question. In the case of junior exploration companies, “control” exists where the entity has a legal right to explore the specified area and exploit any mineral deposits within it (PWC, 2007). The cost of any asset can be measured reliably using the actual expenditure incurred. However, not all pre-exploration meets the requirement that future economic benefits must be probable (PWC, 2007). In these circumstances “future economic benefits” refer to the potential to contribute to the cash flow of the entity (Venter, 2003:2). Even if an asset meets the definition of an element in the financial statements, paragraph 83 of the Framework (IASB, 2010a) stipulates that such an asset may be recognised only if it is probable that future benefits will flow to the entity from that asset and if the asset has a cost or value that may be measured reliably. “Probable future economic benefits” is a stricter criterion than simply possessing the potential to contribute to cash flow (Venter, 2003:2). The expectation that future economic benefits will flow to the entity must be sufficiently certain so as to be regarded as probable (Venter, 2003:2). However, the Framework (IASB, 2010a) does not provide a quantification of the meaning “probable”. Pre-exploration expenditure may, thus, be recognised as an asset only if the asset is under the control of the entity, if it has a cost or value that may be measured reliably and if future economic benefits accruing from that asset are sufficiently certain.

Pre-exploration expenditure usually includes expenditure incurred on the acquisition of third party studies over regions of land, searches to determine the exploration history of an area, the preparatory work of exploration teams and the development of geological hypotheses involving an analysis of structural geology prior to the acquisition of tenement rights

(Williamson, 2005b:65). The treatment of this expenditure will have to be measured in terms of the definitions as contained in the Framework (IASB, 2010a). Generally, pre-exploration expenditure cannot be associated with any specific reserves as they generally are speculative in nature (KPMG, 2005). Although it may be possible to measure the cost of this expenditure reliably the probability of future economic benefits may not be sufficiently certain at the stage at which the expenditure was incurred and, thus, it is highly likely that the expenditure may be recognised as an expense. KPMG (2005) and PWC (2007) confirm that such expenditure should be expensed when incurred.

3.6.2. IAS 16, Property, plant and equipment

IFRSs require the recognition of property, plant and equipment (PPE) as an asset even if it will be used in pre-exploration activities (KPMG, 2005). Although the scope of IAS 16 (IASB, 2010a) excludes the recognition and measurement of exploration and evaluation assets, it does, nevertheless, apply to the PPE that are used to develop these assets. Any items of plant and equipment used during the pre-exploration phase are capitalised within PPE and depreciated over their useful lives (PWC, 2007). Such items are recognised as PPE in accordance with IAS 16 (IASB, 2010a). According to IAS 16 (IASB, 2010a), PPE should initially be measured at cost while the entity concerned has the choice either to measure PPE at the cost or revaluation model after recognition. IAS 16 (IASB, 2010a) further stipulates that the carrying amount of PPE should be reduced by recognising a depreciation expense over the useful life of the asset.

Paragraph 7 of IAS 16 (IASB, 2010a) confirms the recognition criteria as set out in the Framework (IASB, 2010a), namely, the point at which to capitalise costs as an asset. Specifically, IAS 16 (IASB, 2010a), paragraph 10 states that it is essential that an entity assess the recognition principle at the time of recognition. Accordingly, IAS 16 (IASB, 2010a) does not allow the deferral of costs incurred until it is possible to determine the probability of future economic benefits (Venter, 2003:2). Therefore, pre-exploration expenditure cannot be capitalised while the possibility of future economic benefits are determined, because the asset recognition principle according to IAS 16 should be relevant at date of recognition.

3.6.3. IAS 38, Intangible assets

Activities prior to obtaining a prospecting right are effectively pre-exploration (KPMG, 2005). IFRS 6 (IASB, 2010a) does not provide examples of pre-exploration costs, which typically include the acquisition of speculative seismic data and expenditure on the subsequent

geological and geophysical analysis of this data (KPMG, 2005). These costs might qualify for recognition as an intangible asset to the extent that pre-exploration costs give rise to proprietary information that the entity has the ability to control (KPMG, 2005).

According to IAS 38 (IASB, 2010a), an intangible asset is defined as an identifiable, non-monetary asset without physical substance. An intangible asset may be acquired in a number of ways although the manner of acquisition is irrelevant as the intangible asset should initially be measured at its cost. The cost of a separately acquired intangible asset will, according to paragraph 27(a) of IAS 38 (IASB, 2010a), comprise its purchase price, including import duties and non-refundable purchase taxes, as well as certain directly attributable costs. A number of pre-exploration expenditures may include pre-acquisition expenditure relating to the acquisition of an intangible asset, for example expenditure directly attributable to the acquisition or application of a prospecting right. This expenditure will be recognised as part of an intangible asset, for example prospecting rights, in accordance with IAS 38 (IASB, 2010a). According to paragraph 72 of IAS 38 (IASB, 2010a) an entity has the choice to measure the intangible asset either at the cost or the revaluation model after recognition. The intangible asset is amortised over its useful life.

3.7. EXPLORATION AND EVALUATION EXPENDITURE

As soon as a company possesses some form of legal right over exploration, for example its application for a prospecting permit was approved (see section 2.3.6) the exploration and evaluation phase, in accordance with IFRS 6 (IASB, 2010a), commences.

3.7.1. Developing an accounting policy

As discussed above in section 3.5.3 an entity may determine an accounting policy while stipulating which expenditure will form part of exploration and evaluation assets by applying paragraph 10 of IAS 8 (IASB, 2010a) only. IFRS 6 (IASB, 2010a) allows entities temporary exemption from paragraphs 11 and 12 of IAS 8 (IASB, 2010a). Paragraphs 11 and 12 of IAS 8 (IASB, 2010a) stipulate that management should, in making judgments in its devising of an accounting policy, firstly, consider guidance in respect of other IFRSs dealing with similar issues, secondly, refer to the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses as contained in the Framework (IASB, 2010a) and, thirdly, consider the pronouncements of other standard setting bodies. This exemption allows an entity to develop an accounting policy which may not totally comply with the Framework (Holt, 2007).

PWC (2007) is also of the opinion that the exemption means that mining entities may retain the accounting policies they have applied before the issue of IFRS 6 (IASB, 2010a) even if those policies do not comply with the Framework (IASB, 2010a).

Paragraph 10 of IAS 8 (IASB, 2010a) requires that management use its own judgment in developing an accounting policy. It is essential that this policy result in information that is relevant to the decision-making needs of the users of the financial statements and is reliable. In addition, the policy must ensure that the financial statements provide a faithful representation of the financial results and position of the company, reflect the economic substance, and be neutral, prudent and complete. Therefore, the policy must be relevant and reliable (PWC, 2007). According to paragraph 9 of IFRS 6 (IASB, 2010a) it is incumbent on an entity to determine which expenditure may be associated with the finding of mineral resources and recognised as exploration and evaluation assets. The following examples of such costs are provided in IFRS 6 (IASB, 2010a):

- acquisition of rights to explore
- topographical, geological, geochemical and geophysical studies
- exploratory drilling
- trenching
- sampling
- activities in relation to the evaluation of both the technical feasibility and the commercial viability of extracting minerals

The depreciation of items of PPE (for example, drill rigs) used in the exploration phase also represents exploration and evaluation expenditure (PWC, 2007). Any such depreciation is treated on the same basis as the entity's other exploration and evaluation expenditure and may be carried forward as an asset (PWC, 2007). The treatment of general administration and overhead costs that are directly attributable to the exploration and evaluation activities would be included in the entity's choice of accounting policy. It is therefore possible to expense all such costs as a matter of policy, or that can be allocated to exploration projects in the entity and then accounted for on the same basis as the other exploration costs incurred on those projects (PWC, 2007).

The entity must establish a consistent accounting policy for each type of exploration and evaluation cost. In addition, the entity should treat these costs in a consistent manner for

comparable activities and between reporting periods. Any change in the treatment of expenditure deemed to qualify for recognition as an exploration and evaluation asset should be treated as a change in accounting policy and accounted for in accordance with IAS 8 (IASB, 2010a).

In deciding on an accounting policy for exploration and evaluation expenditure the main issue is to determine whether to capitalise these costs or to record them as expenses in the period in which they were incurred. The alternative methods of accounting for exploration and evaluation expenditure as identified during the literature review are discussed below.

3.7.1.1. Full expense method

The full expense method is the most conservative method (Cartwright, 1991) and involves expensing all exploration costs as they are incurred. Exploration activities usually take place over a considerable period of time and with this approach it may be difficult to evaluate a company's efficiency as an operator in the mineral industry (Cartwright, 1991). Cartwright (1991) is of the opinion that this approach serves better to mask the true cost of finding an asset rather than serving to prevent the overvaluation of the asset.

3.7.1.2. Full cost method

The full cost method represents the other extreme treatment of exploration costs (Gerhardy, 1999). The full cost method is one of the two most popular methods in accounting for exploration and evaluation expenditure, the other method is the successful efforts method (Epstein & Jermakowicz, 2009). In terms of the full cost method all exploration costs are capitalised until an ore reserve is eventually found (Cartwright, 1991). This method does not use a separate cost centre based on a particular mineral resource, but uses a larger geographical area (such as a whole country) as its cost centre (PWC, 1999:11). However, there are serious problems associated with this method (Cartwright, 1991). In periods of large write offs this method significantly distorts the net income while in periods in which more than one viable ore deposit is found the problem arises of allocating these capitalised exploration expenses correctly (Cartwright, 1991). This method is commonly used by among junior exploration companies with no producing assets where exploration and evaluation activities are in progress and for which an outcome has not yet been determined (PWC, 2007). This method is the most liberal of all methods.

3.7.1.3. Successful efforts method

As mentioned above in section 3.7.1.2 the successful efforts method is one of the two most popular methods in accounting for exploration and evaluation expenditure (Epstein & Jermakowicz, 2009). The successful efforts method expenses any costs that are not directly related to an ore reserve, for example the costs of drilling activity that does not find any reserves and all costs incurred before discovery (PWC, 1999:11). A major problem with this method is that, until an ore reserve has been defined, the entity will not know which costs to capitalise (Cartwright, 1991). One of the main benefits of this method is that the users of financial statements are able to assess management in terms of its unsuccessful exploration activities (Venter, 2003:3). In view of the lack of accounting for the failed projects that were explored before a successful project was discovered this method actually conceals the actual cost of the asset(s) (Cartwright, 1991). The successful efforts method falls between the expense and the full cost method.

3.7.1.4. Area of interest method

The area of interest method identifies a geological area which, potentially, contains ore reserves and capitalises all costs incurred in identifying or proving the area of interest (PWC, 1999:10). In terms of this method costs are capitalised until the project is proven successful (thus become viable to mine) or otherwise (Gerhardy, 1999). PWC (1999) was of the opinion that this method could be considered as the favoured method of allocating exploration cost and therefore regarded this method as the most appropriate method of accounting for exploration cost (PWC, 1999:10). The area of interest method represents another major approach to the capitalisation of exploration and evaluation expenditure and it is believed to be fairly commonly used in the mining industry (Epstein & Jermakowicz, 2009). This application of this method lies between the successful efforts method and the full cost method.

3.7.1.5. Expense and reinstate method

The expense and reinstate method expenses all exploration costs as they are incurred and, as soon as a viable ore reserve has been detected, the previously related expensed exploration costs will be reinstated as an asset (Gerhardy, 1999). An entity needs adequate internal accounting controls to record separate project expenses in order to ensure that the correct expensed amounts only are reinstated.

3.7.1.6. Area of interest with provision method

The area of interest with provision method capitalises all exploration costs associated with an area and, at the same time, a provision of an equal amount is created against the area by means of a charge to the profit and loss account (Gerhardy, 1999). This full provision remains in place until the economic viability of the area has been established (Gerhardy, 1999). The provision is reversed via the profit and loss account as soon as the economic viability of the area has been established. The net effect of this method and the expense and reinstate method on the financial statements of an entity will be the same.

Junior exploration companies may adopt any of the methods discussed above or any other methods into their accounting policies for exploration and evaluation expenditure as long as the policy selected complies with paragraph 10 of IAS 8 (IASB, 2010a).

According to the Framework (IASB, 2010a) the four principal qualitative characteristics of financial statements are understandability, relevance, reliability and comparability. These characteristics constitute those elements that render the information provided by financial statements useful to the users of the financial statements. The IASB and Financial Accounting Standards Board (FASB) of the United States are involved in a joint project to review and to amend sections of the Framework (IASB, 2010a). The overall objective of this project is to create a sound foundation for principles-based accounting standards. In 2008 the IASB issued an exposure draft relating to the objectives and qualitative characteristics of financial reporting (IASB, 2008). According to this exposure draft the fundamental qualitative characteristics of financial reporting are relevance and faithful representation while comparability, verifiability, timeliness and understandability are enhancing qualitative characteristics (IASB, 2008:6). The comparability of information in financial statements allows the users to compare the financial statements of an entity through time as well as enabling users to compare the financial statements of different entities in order to evaluate the performances and changes in financial position of these entities. IFRS 6 (IASB, 2010a) allows an entity to determine its own accounting policy for the treatment of exploration and evaluation expenditure. However, these varying methods of accounting for exploration and evaluation expenditure unfortunately do not contribute to the qualitative characteristic of comparability and therefore does not allow users of junior exploration companies financial statements to compare different junior exploration companies' financial statements with each other.

3.7.2. Classification

IFRS 6 (IASB, 2010a) requires exploration and evaluation assets to be classified as either tangible or intangible assets according to the nature of the assets acquired. In considering whether the nature of exploration and evaluation assets is tangible or intangible, it may be useful to ask whether the cost add to an item that is a physical asset that itself will be used or, alternatively, to intangible knowledge about where, ultimately to build a physical asset (KPMG, 2005). The classification of these assets affects the subsequent accounting of the assets (Chung & Narasimhan, 2006:287). Examples of intangible assets include (Chung & Narasimhan, 2006:288)

- acquired prospecting rights
- exploration drilling costs
- trenching costs
- sampling costs

Examples of tangible assets include (Chung & Narasimhan, 2006:288)

- exploration equipment such as drilling rigs
- vehicles, pumps, pipes, storage tanks
- core trays and core sheds

Current industry practice for the classification of exploration and evaluation assets varies (KPMG, 2005). Some entities take the view that exploration and evaluation assets form part of PPE because the underlying asset is a tangible asset (i.e., the mineral reserve) (PWC, 2007). Others have concluded that any assets in respect of exploration and evaluation expenditure must be attributed to the relevant exploration/mining licence(s) and recognised as an intangible asset (PWC, 2007).

3.7.3. Rehabilitation liabilities

Included in the elements of cost of exploration and evaluation assets are the costs associated with the obligation in respect of the restoration of an area incurred as a consequence of having undertaken the exploration for and evaluation of mineral resources. IFRS 6 (IASB, 2010a) requires an entity to measure this obligation in accordance with IAS 37 (IASB, 2010a). As discussed in section 2.2.6, the MPRDA stipulates in section 41(1) that an applicant for a prospecting right must make the prescribed financial provision for the rehabilitation or management of negative environmental impacts before the minister approves the environmental

management plan. According to the definitions in IAS 37 (IASB, 2010a) a provision refers to a liability of uncertain timing or amount. In addition, paragraph 14 of IAS 37 (IASB, 2010a) stipulates that a provision should be recognised when an entity has a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. It must also be possible to make a reliable estimate of the amount of the obligation. In accordance with section 41 of the MPRDA prospecting companies has a legal obligation to do rehabilitation. The rehabilitation of the core drilling holes and other infrastructure would undoubtedly, result in an outflow of resources and, in addition, it would also be possible to make a reliable estimate in respect of the rehabilitation of the core drilling holes and other infrastructure. Accordingly, provision for rehabilitation would have to be created as the prospecting activities are undertaken. The initial estimate of the rehabilitation provision is treated consistently with the treatment of the exploration and evaluation expenditure that gave rise to the obligation (KPMG, 2005).

Companies may make financial provision for their rehabilitation obligation by contributing to a decommissioning fund with contributions to these funds being either compulsory or voluntary. Contributors to these funds recognise their obligations to carry out decommissioning or rehabilitation as a liability and recognise their interest in the fund separately (Pretorius, Venter, von Well & Wingard, 2009: 596). The accounting treatment of the interest in the fund is carried out in accordance with IFRIC 5 (IASB, 2010a), *Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds*.

3.7.4. Measurement

At initial recognition exploration and evaluation assets are measured at cost. As discussed in section 3.7.2 exploration and evaluation assets may be classified either as tangible or intangible. The measurement after recognition guidelines contained in either IAS 16 (IASB, 2010a) or IAS 38 (IASB, 2010a) will be used depending on the classification of the asset.

According to paragraph 12 of IFRS 6 (IASB, 2010a), subsequent to initial recognition an entity should choose either the cost or the revaluation model to be applied to the assets. In terms of the revaluation model the principles of revaluation as specified by IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a) will apply (Chung & Narasimhan, 2006:288).

3.7.4.1. Cost model

Exploration and evaluation assets classified as tangible assets are measured according to paragraph 30 of IAS 16 (IASB, 2010a) and carried at cost less accumulated depreciation and any accumulated impairment losses.

Exploration and evaluation assets classified as intangible assets are measured according to paragraph 74 of IAS 38 (IASB, 2010a) and carried at cost less accumulated amortisation and any accumulated impairment losses.

In terms of the cost model the costs of either tangible or intangible assets are depreciated or amortised over the estimated useful life of the assets concerned (Chung & Narasimhan, 2006:288). An entity will also evaluate the assets for permanent impairment and recognise these impairments in the profit and loss account (Chung & Narasimhan, 2006:288). In determining impairment the entity shall apply IAS 36 (IASB, 2010a) (refer to section 3.7.5).

3.7.4.2. Revaluation model

According to IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a) the revaluation model permits revaluation when specified requirements are met. Exploration and evaluation assets classified as tangible assets are measured according to paragraphs 31 to 42 of IAS 16 (IASB, 2010a) and carried at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The revaluation model of IAS 16 (IASB, 2010a) refers only to market-based evidence and, if there is no market-based evidence, the fair value will be calculated by using either an income or a depreciated replacement cost approach. Tangible exploration and evaluation assets generally are specialised and rarely sold and it may be difficult to find an observable market that may serve as a basis for estimating market value (KPMG, 2005). As the income that may be produced in the future by an exploration and evaluation asset are highly uncertain, it is unlikely that an income approach will give a reliable estimate of fair value of a tangible exploration and evaluation asset (KPMG, 2005). Due to the difficulties in determining the fair value for tangible exploration and evaluation assets, it is anticipated that the revaluation of these assets will be rare (KMPG, 2005).

Exploration and evaluation assets classified as intangible assets are measured according to paragraphs 75 to 87 of IAS 38 (IASB, 2010a) and carried at a revalued amount, being its fair value at the date of revaluation less any subsequent accumulated amortisation and subsequent accumulated impairment losses. The revaluation model in IAS 38 (IASB, 2010a) may be used only if it is possible to establish the asset's fair value by reference to an active market. An active market exists if all of the following conditions are met (Chung & Narasimhan, 2006:289):

- The traded items are homogenous.
- There are normally willing buyers and sellers available.
- Prices are made available publicly.

It will be very rare for an intangible exploration and evaluation asset to meet the abovementioned criteria (KPMG, 2005).

In terms of the revaluation model, an entity revalues assets to their fair value to ensure that their carrying amounts are not materially different from their fair values at the time of reporting (Chung & Narasimhan, 2006:288). However, the accounting standards does not specify how often assets should be revalued although they do indicate that the frequency will depend upon the changes in fair values of the assets.

3.7.5. Impairment

IFRS 6 (IASB, 2010a) requires an entity to apply IAS 36, to measure, present and disclose the impairment of exploration and evaluation assets (KPMG, 2005). According to paragraph 18 of IFRS 6 (IASB, 2010a) exploration and evaluation assets are tested for impairment if the possibility exists that the carrying amount of these assets may not be recoverable. In order to identify an exploration and evaluation asset that may be impaired paragraph 20 of IFRS 6 (IASB, 2010a) is applied and not paragraphs 8 to 17 of IAS 36 (IASB, 2010a). Paragraph 20 of IFRS 6 (IASB, 2010a) identifies the following as a non-exhaustive list of facts and circumstances that might indicate the need for an impairment test (IASB, 2010a):

- The period for which the entity had the right to explore in a specific area has expired or will expire in the near future, and is not expected to be renewed.
- Substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted for nor planned.
- 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.

- Sufficient data exists to indicate that, although the 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 by either successful development or by sale.

As discussed in section 2.2.6 the MPRDA specifies that a prospecting right may not exceed five years and it may be renewed once for a period not exceeding three years. Accordingly, a company will need to keep a record of each prospecting permit issued or renewed as the remaining period of a permit and the intention to renew a permit would indicate the need for an impairment test.

It is, however, not necessary that exploration and evaluation assets be tested for impairment until such time that sufficient data is available to determine the technical feasibility and commercial viability of these assets (Nichols, 2005:270). When such information becomes available or when other facts and circumstances suggest that the asset might be impaired, it is essential that the exploration and evaluation assets be assessed for impairment.

In the absence of any impairment events the directors can use the technique of scaling (Williamson, 2005b). On a day-to-day basis it is recommended that exploration companies go through a process of establishing the likely commercial development of each area. This assessment could be as simple as rating each area of interest on a scale between one and ten with one representing greenfield start-up exploration projects and ten representing projects which almost certainly will progress to development (Williamson, 2005b). Such an assessment will result in the fact that, ultimately, areas of interest may move up and down within the scale, based on the assessment of exploration results to date (Williamson, 2005b). The table produced may be used by directors and auditors to identify projects that are constantly dropping in scale to the point where an impairment event may be indicated.

As this type of asset does not generate cash inflows it is tested for impairment as part of a group of assets (Holt, 2007). IFRS 6 (IASB, 2010a) paragraph 21 specifies the level at which exploration and evaluation assets may be assessed for impairment. An entity should develop a policy of allocating these assets to groups of CGUs and apply the policy consistently. The limitation as specified in IFRS 6 (IASB, 2010a) is that the CGU to which the assets are allocated should not be larger than a segment of the entity as specified by IFRS 8 (IASB, 2010a). IAS 36 specifies that a CGU is the smallest unit for which independent cash flows may be determined

(Holt, 2007). Accordingly, IFRS 6 allows some flexibility when defining a CGU (Holt, 2007). This may mean that each area of interest, contiguous ore body or extraction unit (such as an oil rig) may be treated as a CGU. The identification of CGUs requires judgement and may be one of the most difficult areas of impairment testing for exploration and evaluation assets (KPMG, 2005). KPMG performed a review of mining companies in 2009 and found that companies did not disclose how exploration and evaluation assets were allocated to CGUs (KPMG, 2009).

IFRS 6 specifies the identification and level of impairment of exploration and evaluation assets although the impairment is measured in accordance with IAS 36 once the impairment has been identified (Nichols, 2005:270). IAS 36 requires the impairment loss to be taken into profit and loss when the recoverable amount of the CGU is less than the carrying amount of the unit (Nichols, 2005:271). The recoverable amount of a CGU is the higher of its fair value less cost to sell and its value in use. The value in use may be determined by discounting future cash flows (Nichols, 2005:271). The determination of the recoverable amount per CGU will require the preparation of reasonably comprehensive valuation reports (Williamson, 2005b). Such valuation reports would need input from qualified geologists, other geo-scientists, engineers and project valuers (Williamson, 2005b). Small to medium size exploration companies may limit the scope of such valuation processes to in-house studies (Williamson, 2005b). However, the issue of independence in the valuation process may become very important and companies may find it expedient to approach external consultants to complete the necessary supporting reports that may be used to support the company's approach to valuation and methodologies (Williamson, 2005b). Companies will need to develop quality relationships with valuers and experts in the valuation process to enable the exploration company to ensure that their valuation approach and methodologies are acceptable, sufficiently comprehensive and independent.

The reversal of impairment losses is required when specified requirements, as stipulated in paragraphs 109 to 126 of IAS 36 (IASB, 2010a), are met. In such cases, the carrying amount of the asset is increased to the recoverable amount, not to exceed what the carrying amount would have been if no impairment loss had been recognised (Nichols, 2005:271).

3.8. NEW DEVELOPMENTS

A DP on extractive activities (IASB, 2010b) was issued by the International Accounting Standards Board (IASB) in April 2010 and made available on the IASB website. By 30 July 2010 comments on the DP had been received by the IASB. In 2011, the IASB plans to make a

decision on whether the extractive activities project should be added to its active agenda. If the IASB decides to add the project to its agenda then an IFRS will be developed on accounting for extractive activities and would supersede IFRS 6 (IASB, 2010a).

This DP presented the findings and recommendations of the project team although the IASB has not yet developed preliminary views on the recommendations from the project team (IASB, 2010b:7). The scope of this DP encompasses the financial reporting issues relating to the exploration for and the finding of minerals and oil and natural gas deposits, the developing of these deposits and the extracting of the minerals and oil and natural gas (IASB, 2010b:15). These activities may be referred to as extractive activities or upstream activities (IASB, 2010b:15). However, the researcher will highlight only the recommendations of the project team as this could influence future accounting practices of junior exploration companies.

The DP (IASB, 2010b) proposes that the scope of an extractive activities IFRS should include the extractive activities in respect of minerals, oil or natural gas and that there should be a single accounting and disclosure model that applies to extractive activities in both the mineral as well as the oil and gas industries.

Reserves and resources comprise the most significant assets of most entities involved in extractive activities (IASB, 2010b:24). The DP noted that the definition of both a reserve and a resource may vary depending on the industry, the jurisdiction and the reason why the estimate is being prepared (IASB, 2010b:26). The DP proposes the use of mineral reserve and resource as defined in the Committee for Mineral Reserves International Reporting Standards (CRIRSCO) and the oil and gas reserve and resource definition as established by the Petroleum Resource Management System (PRMS) (IASB, 2010b:46). It should be noted that the definitions of mineral reserves and resources in the SAMREC Code (SAMCODE, 2007) are based on the definitions as per CRIRSCO.

An important aspect of the accounting for extractive activities is the identification of whether and when to recognise the asset that develops as the extractive activities are being undertaken (IASB, 2010b:47). The DP proposes that legal rights, such as prospecting or mining rights, form the basis of the mineral or oil and gas asset (IASB, 2010b:9). The asset would be recognised when the legal right is obtained and information that is obtained from subsequent exploration, evaluation and development activities would both be treated as development of the legal rights

asset (IASB, 2010b:9). The level of detail at which this asset will be recognised and presented in the financial statements should also be determined. The DP proposed that the unit of account would initially be defined according to the geographical area in terms of which the prospecting rights were held (IASB, 2010b:9). The unit of account would become progressively smaller as exploration, evaluation and development activities took place until it had become either a single area or contiguous areas that were managed separately and would be expected to generate independent cash flows (IASB, 2010b:9).

The two main measurement bases used in financial reporting may be broadly categorised as either historical cost or current value (IASB, 2010b:71). Current value measures include fair value and value in use (IASB, 2010b:71). According to the research conducted by the project team in general, the users of financial statements are of the opinion that measuring these assets at either the historical cost or current value would provide them with limited relevant information (IASB, 2010b:9). The DP proposes that these assets be measured at historical cost and that detailed disclosure about the mineral or oil and gas assets should also be provided (IASB, 2010b:10). IFRS 6 (IASB, 2010a) allows for the subsequent measurement of exploration and evaluation assets at cost or using the revaluation model.

The DP also proposes that, prior to development, the exploration assets not be tested for impairment in accordance with IAS 36 (IASB, 2010a) but rather that they should be tested for impairment only if management has determined that there is a significant possibility that the carrying amount of the exploration asset will not be recovered. (IASB, 2010b:10). IFRS 6 (IASB, 2010a) stipulates that the assessment of the impairment of exploration and evaluation assets should be triggered by changes in facts and circumstances.

As discussed above, disclosure relating to the mineral, oil and gas assets is important for the users of the financial statements although the disclosure requirements according to IFRS 6 (IASB, 2010a) are extremely limited. The DP proposes that the disclosure objectives for extractive activities are aimed at enabling users to estimate the value attributable to the mineral, oil and gas assets of an entity; the contribution of these assets to current period financial performance and the nature and degree of risks and doubts associated with these assets (IASB, 2010b:10). In order to meet the abovementioned disclosure objectives the project team proposed that the following information be disclosed in the financial statements (IASB, 2010b:11):

- “Quantities of proved reserves and proved plus probable reserves, with the disclosure of reserve quantities presented separately by commodity and by material geographical area;
- The main assumptions used in estimating reserves quantities, and a sensitivity analysis;
- A reconciliation of changes in the estimate of reserve quantities from year to year;
- A current value measurement that corresponds to reserve quantities disclosed with a reconciliation of changes in the current value measurement from year to year;
- Separate identification of production revenues by commodity; and
- Separate identification of the exploration, development and production cash flows for the current period and as a time series over a defined period (such as five years).”

The lack of transparency in many African countries means that very little of their natural mineral wealth is either shared by or transferred to the people of African countries (Games, 2010). The corruption and lack of development in many African resource-rich countries has meant that these countries are, in the main, near the bottom of the United Nations Human Development Index (Games, 2010). The IASB and the Revenue Watch Institute sponsored a discussion on the Publish What You Pay (PWYP) campaign (IASB, 2010b:145). This campaign encourages companies to disclose the amounts they pay to resource-rich developing countries and it aims to hold these governments accountable for the management of the revenue they receive from their mineral, oil and gas industries (IASB, 2010b:145). The project team found that disclosure of the payments made to governments provides useful information for users although it also found that obtaining this information might be difficult and costly (IASB, 2010b:11). The disclosure of PWYP will support better governance on the part of stakeholders in the resource sector.

The proposals contained in the DP (IASB, 2010b) on extractive activities will influence mainly the disclosure in financial statements. However, according to these proposals these assets will not be allowed to be valued according to their fair value or value in use. The disclosure requirements will enable users to use the information in their own valuation models and to make their own assumptions and estimates regarding the underlying mineral, oil and gas assets to be found in extractive entities.

3.9. SUMMARY AND CONCLUSION

Junior exploration companies are involved in the pre-exploration and exploration phases of mining. IFRS 6 does not apply either to expenditure incurred before an entity obtains the legal right to explore or to expenditure incurred after the technical feasibility and commercial viability

of an area has been established. Therefore, junior exploration companies use the definitions of assets and expenditure in the Framework and apply the principles of asset recognition in IAS 16 and IAS 38 for the accounting treatment of pre-exploration expenditure. It is not common that mining companies disclose an accounting policy for pre-exploration expenditure (KPMG, 2009). According to the Framework, pre-exploration expenditure may be recognised as an asset only if the asset is under the control of the entity, if it has a cost or value that may be measured reliably and if future economic benefits accruing from that asset are sufficiently certain. Junior exploration companies could interpret the definition of an asset differently and therefore create various accounting practices in the treatment of pre-exploration expenditure.

The focus of IFRS 6 is on exploration and evaluation expenditure incurred during the exploration phase. IFRS 6 allows an entity to determine its own accounting policy which will, in turn, stipulate what expenditure will form part of exploration and evaluation assets by applying paragraph 10 of IAS 8. As discussed in section 3.7.1 there are various methods of accounting for exploration and evaluation assets. However, IFRS 6 does not remedy the lack of uniformity in the accounting practices of exploration companies and neither does it contribute to one of the basic qualitative characteristics of the Framework, namely, comparability. The exemption of paragraphs 11 and 12 of IAS 8 in IFRS 6 allows an entity to develop an accounting policy, which may not fully comply with the Framework. The range of accounting policies highlights the significant flexibility allowed by IFRS 6 and therefore creates various accounting practices used by junior exploration companies in the accounting for exploration and evaluation expenditure.

Extractive companies constitute a major portion of the global economy. However, IFRS 6 covers a small fraction only of the activities undertaken by extractive companies and it allows companies to use fairly different accounting policies, thus effectively exempting them from applying the Framework. Accordingly, a standard is required that will both address all the phases of mining in which extractive companies participate and standardise the industry's reporting. A draft DP on extractive activities was published in August 2009 and the final DP issued for comment in April 2010. In the main, the proposals of the project team of the DP recommended that exploration assets be measured according to the cost model and that detail disclosure of these assets be included in the financial statements of an entity. The request for comments on the DP closed on 30 July 2010. The IASB work plan indicates that the IASB plans to make a decision in 2011 as to whether the extractives activities project should be added to its

active agenda. It is clear that a comprehensive standard dealing with extractive industries will be available only in a number of years.

The next chapter considers the Income Tax Act and discusses the possible practical interpretations of the Income Tax Act by junior exploration companies.

CHAPTER 4

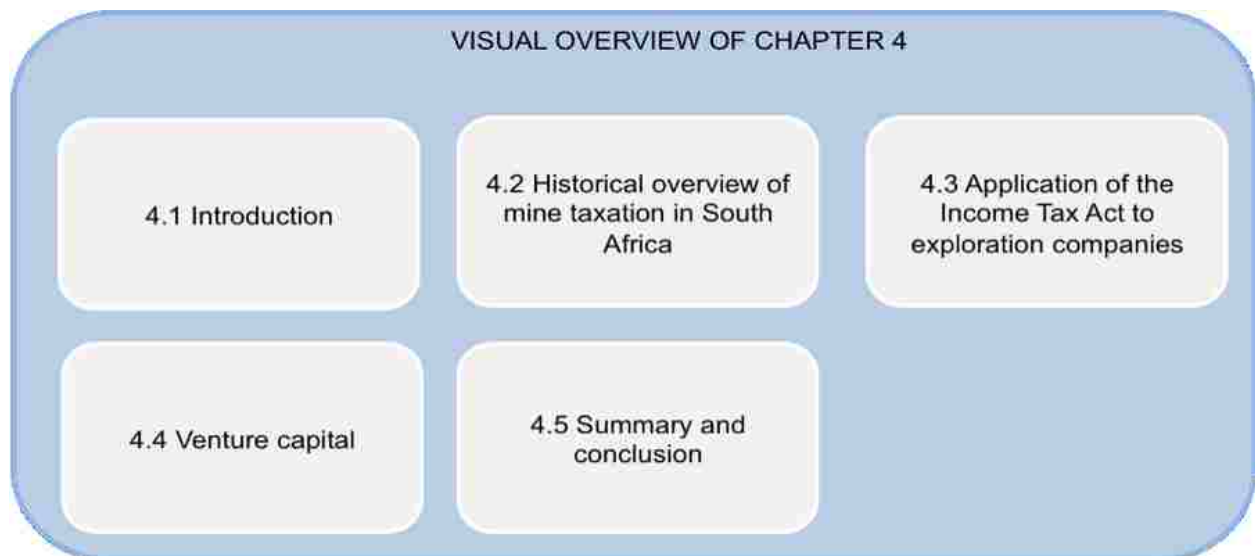
LITERATURE REVIEW: TAXATION PRACTICES

4.1. INTRODUCTION

Minerals have been mined for thousands of years and governments throughout history have taxed mines in order to share in the riches, which derive from minerals (Otto, 2000:1). One of the main objectives of mine taxation is to raise revenue for the government (Otto, 2000:1). Nevertheless, most governments try to strike a balance between their own long-term interests and the commercial interests of the investors (Speed & Rogers, 1999). Before the promulgation of the Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA) in May 2004, Jourdan (as cited in Cawood & Minnitt, 1998:373) was of the opinion that the large mining houses held almost all the mineral rights in South Africa. As a result it was the large mining houses that carried out almost all the exploration work. The change in the mineral policy of South Africa was confirmed with the promulgation of the MPRDA with a consequence of this change being that a large number of junior exploration companies and investors obtained prospecting rights. These junior exploration companies are conducting prospecting in the hope of locating lucrative mineral deposits with the objective of selling the prospecting rights at a profit or establishing a mine.

The Income Tax Act 58 of 1962, as amended (Income Tax Act), contains special deduction provisions in sections 15, 36 and 37 that apply to taxpayers who derive income from mining operations. "Mining" and "mining operations" are both defined in section 1 of the Income Tax Act although the Act does not define either the terms "prospecting" or "exploration". In terms of section 15(b) of the Income Tax Act, a special deduction is granted from the income derived by a taxpayer from mining operation. This special deduction relates to expenditure incurred on prospecting operations.

The aim of this chapter is to investigate the Income Tax Act and to identify and discuss possible practical applications of the Income Tax Act by junior exploration companies that could lead to various tax practices. The layout of the chapter is as follows:



4.2. HISTORICAL OVERVIEW OF MINE TAXATION IN SOUTH AFRICA

A short history of the development of mining taxation is discussed below: this shows that mining tax reform was last carried out in the early 1990's, when large mining houses carried out most of the exploration work. Figure 4.1 provides an overview of the development of mine taxation in South Africa.

Date	Event
2009	Section 12J Deductions in respect of expenditure incurred in exchange for issue of venture capital company shares.
2008	Mineral and Petroleum Royalty Bill introduced (deferred to 2010).
2001	Introduction of Capital Gains Tax.
1993	Introduction of Secondary Tax on Companies.
1988	Marais Committee retain formula tax on gold mines and relax ring fencing.
1985	Ring fencing restrictions on capital expenditure introduced.
1973	100% capital redemption allowance extended to all mines.
1945	Holloway Committee recommend only the use of formula tax on gold mines.
1936	Corbet Committee introduce two-tier tax system on gold mines; formula tax and flat tax rate.
1926 – 1935	Mining companies taxed at higher rates than other companies.
1925	Dividend taxes eliminated.
1917	Flat tax rate of 5% on all companies and dividend withholding tax introduced.
1914	First Income Tax Act that covers all companies and individuals in South Africa.
1910	Taxation of profits on all types of mines (10% on gold mines, 10% on diamond mines and sliding scale of 2,5% - 9% on all other mines).
1902	Direct tax on gold mines at 10% of net profits.
1898	Direct tax on gold mines at 5% of net profits.
1875	Mining taxation of 3 shillings per ounce of gold.

Figure 4.1: Historical overview of mine taxation in South Africa

Source: Own observation

The mining tax system in South Africa was introduced in 1875 at a rate of 3 shillings per ounce of gold produced (Marais, 1988:126). In 1898 the first direct tax on gold mining profits was introduced at a rate of 5% on net profits (Deetlefs, 1991). In 1902 new legislation was introduced by the British administration that increased the tax rate to 10% on net profits and defined the tax profit base (Marais, 1988:127). With the establishment of the Union of South Africa in 1910 the

Mining Taxation Act replaced previous mining tax legislation and imposed taxation on the profits from all types of mining (Deetlefs, 1991). The tax rates on net profit were 10% on gold mining, 10% on diamond mining and 2,5 to 9% depending on the ratio of profit to revenue for other mining (Marais, 1988:128).

The first Income Tax Act covering the whole of South Africa was introduced in 1914 (Marais, 1988:128). Mining companies continued to pay taxes as mentioned above but non-mining companies and individuals paid tax on a sliding scale of up to 7,5% (Marais, 1988:128). In 1917, the income tax rates were replaced with a 5% flat rate on all companies – mining and non-mining – and a dividend withholding tax was introduced (Marais, 1988:128). In 1925 the dividend taxes were eliminated but, from 1925 to 1935, mining companies were always taxed at higher rates than other companies (Deetlefs, 1991).

In 1935 the Corbet Committee was constituted to investigate the taxation of gold mines (Marais, 1988:131). This committee concluded that a tax system should be developed to support both marginal ore mining and deep level mining while safeguarding the government's share in profits (Deetlefs, 1991). The committee's recommendations of a two-tier tax system, namely, a basic flat rate tax of 15% and a formula tax or surtax of $y = 40 - (40 \times 12,5/x)$, were accepted (Marais, 1988:132). In terms of the formula tax or surtax "y" represented the tax rate to determine and "x" was referred to as the profit to revenue ratio (Van Blerck, 1992:8–2). The formula taxed profits at a marginal rate of 40% but only if the profit to revenue ratio exceeded 12,5% (Van Blerck, 1992:C–5). This system remained in place until 1945 although, during the war years, special contributions were levied on all companies (Deetlefs, 1991).

The Holloway Committee was formed after world war 2 to investigate gold mine taxation yet again (Deetlefs, 1991). Most of the committee's recommendations were enacted in 1946 and resulted in the formula tax becoming the sole income tax gathering mechanism with the formula being changed to $y = 70 - (420/x)$ (Deetlefs, 1991) with "y" representing the tax rate to determine and "x" being referred to as the profit to revenue ratio (Van Blerck, 1992:8–2). The capital redemption allowances were changed to 100% for new gold mines and 20% for other gold mines (Marais, 1988: 136). Various changes were later made to the parameters of the gold mining formula and the capital redemption allowances were extended to non-gold mines. Ring fencing was introduced in 1985 (Deetlefs, 1991).

In November 1986, the Margo Commission appointed a technical committee, the Marais Committee, to investigate matters relating to mining taxation (Marais, 1988). This investigation took place during a time of mounting operating costs, declining profits and high taxes (Deetlefs, 1991). The summarised recommendations of the Marais Committee are as follows:

- Retain the 100% capital redemption allowance.
- Relax ring fencing to encourage new mining ventures.
- Phase out surcharges on non-gold mines.
- Phase out lease payments to the state where the state is not the owner of the mineral rights (Deetlefs, 1991).
- Retain formula tax ($y = a - ab/x$) on gold mines but reduce the tax rate to bring it in line with the tax on other companies with the “y” in the formula representing the tax rate to determine, “a” the marginal tax rate, “b” the portion of tax free revenue and the “x” being referred to as the profit to revenue ratio (Van Blerck, 1992:8–2).

Most of the recommendations made by the Marais Committee were acted on in the tax amendments announced by the Minister of Finance in his budget speech of 1991 (Van Blerck, 1991).

The election of a democratic government in 1994, approximately thirty years after the colonial era had ended elsewhere in the world, meant that South Africa had to move from the colonial to the modern era (Cawood & Minnitt, 1999:345). Since the recommendations of the Marais Committee and the 1991 tax amendments no material changes regarding the special deduction provisions of mining companies have taken place.

4.3. APPLICATION OF THE INCOME TAX ACT TO EXPLORATION COMPANIES

Apart from specific deduction provisions contained in sections 15, 36 and 37 of the Income Tax Act, its provisions generally also apply to taxpayers who derive income from mining operations.

4.3.1. Income from mining operations

The Income Tax Act contains special deduction provisions in sections 15 and 36 that pertain to deductions from income derived from mining operations. Section 15(b) specifically deals with expenditure incurred by a taxpayer on prospecting operations. In order to decide whether a taxpayer derives income from mining operations there are two steps necessary to determine mining income (Van Blerck, 1992:10–2). Firstly, it is necessary to define the term “mining

operations” and, secondly, to determine what income is derived from these activities (Van Blerck, 1992:10–2). In this context the definition of “mining” and “mining operations” for tax purposes as found in section 1 of the Income Tax Act. The definitions of “mining” and “mining operations” is limited to the definitions contained in section 1 of the Income Tax Act refer to every method or process by which a mineral is won from the soil or from any substance or constituent thereof. In *Commissioner of Taxes (COT) v Nyasaland Quarries and Mining Co Ltd* (24 SATC 579 at 582), Spencer Wilkinson CJ, stated the following:

In my opinion there can be no doubt whatever that in defining the expressions “mining operations” and “mining” as it has done, the legislature intended to give these expression, when used elsewhere in the Act, a meaning wider than the ordinary everyday meaning of those terms. Moreover, the extension of the usual meaning of those expressions is obviously intended to be a wide one, for the words used are very general. “Mining operations” and “mining” are to include every method or process by which any mineral is won. It is hardly possible to imagine more general words.

The definition of “mining” and “mining operations” may, thus, be seen as extremely comprehensive.

Before mining operations may commence, it is necessary to find mineral reserves (KPMG, 1993:1). This is a time consuming and costly exercise as, although prospecting has advanced technologically in many ways, it is still extremely costly and full of risk (KPMG, 1993:1). The Income Tax Act does not define the terms “prospecting” or “exploration”. Although the definition of “mining” and “mining operations” may be seen as extremely comprehensive the question arises as to whether this definition includes the prospecting and exploration activities of junior exploration companies. In the *Murchison Exploration and Mining Co Ltd v Commissioner for Inland Revenue (CIR)* (10 SATC 143) the taxpayer was a newly established company that was prospecting in order to establish a mine. The taxpayer incurred exploration and prospecting costs in its first year of operation while, during the same period, the taxpayer earned interest on funds. The tax authorities wanted to tax the interest at the higher tax rate applicable to gold mining income rather than at the lower rate of tax applicable to other income. In *Murchison Exploration and Mining Co Ltd v CIR (supra)* Maritz J, stated (at 148) the following:

In so far as the Income Tax Act is concerned, mining is the process by which minerals are won from the soil for the purpose of profit. Prospecting and exploration and assaying work are merely methods adopted in order to test the property in order to see whether it is worthwhile mining.

Thus, in the case of a company that is involved entirely in prospecting and exploration activities the activities of such a company do not constitute “mining operations”.

In order to determine mining income it is, secondly, necessary to determine what income is derived from the mining activities. In a Privy Council judgement in 1900 the following was stated (Van Blerck, 1992:10–3): “Their Lordships attach no special meaning to the word ‘derived’ which they treat as synonymous with arising or accruing.” In *Port Elizabeth Municipality v Union Government (Minister of Railways & Harbours) Respondent* (1918 AD 237 at 244), Innes C J, expressed the following: “The income of a trading business is not derived from the shop in which it is carried on, but from the sales there transacted.”

“To put the matter simply, where income is derived directly from the utilisation of mining assets (including intangible assets such as mining rights for the purposes of the taxpayer’s own mining operations) such income will be mining income; where income is only indirectly derived from such assets, or is derived from other assets, this income will tend to be non-mining income.” (Van Blerck, 1992:10–3). In *Western Platinum Limited v Commissioner for SARS* ([2004] 4 All SA 611 (SCA)) the interpretation of the phrase “income derived from mining operations” was confirmed to mean income derived from the business of mining operations in the sense of extracting minerals from the soil. Accordingly, income directly derived from or connected to the business of mining operations only would qualify as mining income.

The prospecting and exploration activities performed by junior exploration companies do not constitute, according to the Income Tax Act, mining operations. The special deduction provisions in the Income Tax Act that specifically deals with expenditure incurred by a taxpayer on prospecting operations, only allows the special deduction against income from mining operations. Therefore, junior exploration companies are not allowed to use the special deduction provision as their activities do not constitute mining operations.

4.3.2. Nature of exploration expenditure

It is important to determine the nature of prospecting expenditure as expenditure of a revenue nature may qualify for deduction in terms of the general deduction formula while expenditure of a capital nature may only be deducted if a special deduction provision exists (Van Blerck, 1992:9–4). The exploration and evaluation costs incurred by an exploration company may be of a capital or a revenue nature. The nature of exploration expenditure depends on the intention of the junior exploration company. The term “gross income” is defined in section 1 of the Income Tax Act as “... the total amount, in cash or otherwise, received by or accrued to or in favour of such resident ... during such year or period of assessment, excluding receipts or accruals of a capital nature, ...”.

The Income Tax Act does not define the term “of a capital nature” but, over the years, the courts have established various methods which they apply in order to determine the nature of either a receipt or accrual. In *CIR v Stott* (3 SATC 253) the judge highlighted the fact that the intention of the taxpayer is an important factor to take into account when the nature of a receipt or accrual is determined. The intention of a taxpayer needs to be established, firstly, at date of acquisition and, secondly, during the period over which the asset was held and, lastly, at the time the asset was disposed off (Stiglingh, Koekemoer, van Schalkwyk, Wilcocks, de Swardt & Jordaan, 2010: 27). However, it is possible that the taxpayer have mixed intentions at the time the asset is acquired. The *CIR v Lydenburg Platinum Ltd* (4 SATC 8) case determined that the dominant intention of a taxpayer must be established by looking at the specific facts of the case, which may take into account the subsequent actions of the company. In terms of *CIR v Stott (supra)* a taxpayer is entitled to dispose of a capital asset to the best of his ability and there must be proof of some special acts which indicate that the taxpayer had conceived some scheme of profit making.

In *Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste* (39 SATC 163) it was determined that inquiries had to be made to establish whether the taxpayers were merely realising a capital asset to their best advantage or using the asset in a scheme of profit making. The golden rule in determining the nature of a receipt or accrual is to establish the intention of the taxpayer and whether the original intention has changed to a scheme of profit making. If the taxpayer’s intention was to make a profit out of the acquisition and disposal of the asset then the intention is clearly revenue.

Section 82 of the Income tax Act places the onus of proof regarding the non-taxability of an amount on the taxpayer. If there is a dispute regarding the capital nature of an amount the court will take into account the following objective factors (not exhaustive list) (Stiglingh, Koekemoer, van Schalkwyk, Wilcocks, de Swardt & Jordaan, 2010:28):

- The taxpayer's *ipsi dixit* (what he indicated his intention was).
- The length of time the asset was held.
- The frequency of the transactions dealing with similar assets.
- The nature of the taxpayer's business.
- Documentary evidence.
- Accounting treatment of the proceeds.
- The reasons surrounding the disposal of the asset by the taxpayer.

It is, however, essential that the circumstances of each case be investigated as the factors listed above do not provide decisive evidence of the taxpayer's intention.

The nature of capital receipts and accruals may be explained in terms of the fact that capital is the income-producing machine and the product of this machine is income (Van Blerck, 1992:3–15). Capital expenditure will generally result in the creation of a lasting benefit for the company (KPMG, 1993:25). This principle was confirmed in *Phalaborwa Mining Company Limited v Secretary for Inland Revenue (SIR)* (35 SATC 159). The company incurred expenditure in order to build a barrage across a river merely to provide the company with the water necessary to bring forward its production date by eight months. This expenditure was held to be of revenue nature as it did not create an enduring benefit. Expenditure of a capital nature produces income or a lasting benefit to the taxpayer for a reasonably long period.

The intention of junior exploration companies is either to conduct the business of prospecting for speculative purposes or to establish a mine. If prospecting is conducted in the hope of locating remunerative mineral deposits with the objective of selling the rights at a profit then the exploration expenditure incurred is of a revenue nature (Van Blerck, 1992:9–5). However, if prospecting is conducted in order to establish a mine the exploration expenditure incurred by the junior exploration company is of a capital nature (Van Blerck, 1992:9–4).

4.3.3. Prospecting by a speculator

When a junior exploration company is prospecting with the intention to sell the prospecting rights and the knowledge gained from the exploration work at a profit, the entity is conducting business

for speculative purposes. Section 11(a) of the Income Tax Act determines that a taxpayer is allowed to deduct from income derived from carrying on a trade any expenditure and losses actually incurred in the production of income, provided that such expenditure is not of a capital nature. In other words, the requirements of section 11 of the Income Tax Act are, firstly, that a taxpayer must be carrying on a trade and, secondly, that income must be derived from such trade. However, section 11(a) of the Income Tax Act must be read together with section 23 of the Income Tax Act which disallows the deduction of certain types of expenditure. Section 23(g) of the Income Tax Act prohibits the deduction of any moneys claimed as a deduction to the extent that the moneys are not laid out or expended for the purpose of the trade. Section 11(a) of the Income Tax Act is known as the positive test while section 23(g) of the Income Tax Act is the negative test.

The term “trade”, as defined in section 1 of the Income Tax Act, may be summarised so as to include every profession, trade, business, employment, calling, occupation or venture, including the letting of property and the use of any patent, design, trademark, copyright or any other property of similar nature. In the *De Beers Holdings (Pty) Ltd v CIR* (47 SATC 229) case the judge accepted that a company could carry on a non-profit making trade although the trade must generate some sort of business benefit.

Prospecting by junior exploration companies with speculative intentions or with the objectives of selling the rights constitutes a trade and, as the expenditure concerned would be in the production of income and for the purpose of the trade, the exploration expenditure would be deductible in terms of the general deduction formula of section 11(a) of the Income Tax Act. As discussed in section 4.3.2, the nature of the exploration expenditure under these circumstances would be of a revenue nature. The proceeds from the sale would be included in the gross income of the taxpayer and would be taxable as non-mining income. The trade of junior exploration companies with a speculative intention is to sell rights and, thus, do not carry on mining activities (see discussion in section 4.3.1) and do not derive income from the business of mining operations in the sense of extracting minerals from the soil. Accordingly, the proceeds from the sale would be taxed as non-mining income.

The possibility also exists that the exploration expenditure incurred at any stage may be considered as trading stock, subject to being brought into taxable income under section 22(1) of the Income Tax Act (KPMG, 1993:11). In essence, trading stock is defined in the Income Tax

Act as anything acquired, produced, constructed, manufactured or assembled with a revenue intention i.e. for resale at a profit. The costs incurred in obtaining the prospecting rights and exploration expenditure would, therefore, result in an allowable deduction in terms of section 11(a) of the Income Tax Act as such expenditure is being incurred in the production of income. The proceeds from the disposal of the trading stock would be included in the gross income and would, as non-mining income, be taxable. Below is an example that illustrates the possibility of considering exploration expenditure as trading stock.

Example of section 22 (opening and closing stock):

Exploration and prospecting right expenditure of R100 incurred in 2008. The prospecting right sold in 2009 for R120. The effect of these transactions on the taxable income for the years ended February 2008 and 2009 would be as follows:

	R:
2008: Gross income - sales	Nil
Section 11(a) deduction - expenditure	(100)
Section 22(1) closing stock – add to income	100
Taxable income	<u>Nil</u>
2009: Gross income - sales	120
Section 11(a) deduction - expenditure	Nil
Section 22(2) opening stock – deduct from income	(100)
Section 22(1) closing stock – add to income	Nil
Taxable income	<u>20</u>

The effect of section 22 of the Income Tax act is that this section postpones the deduction of the expenditure until the year of sale and, therefore, matches the deduction with the income.

Section 11 of the MPRDA stipulates “a prospecting or mining right or any interest in such right or a controlling interest in a company ... may not be ceded, transferred, let, sublet, assigned,

alienated or otherwise disposed of without the written consent of the Minister, except in the case of change of controlling interest of a listed company.” Accordingly, prospecting with a speculative intension is extremely complex and time consuming as written consent of the Minister is required for each prospecting right that is disposed.

4.3.4. Prospecting to establish a mine

When junior exploration companies are prospecting with the intention to establish a mine the exploration expenditure is of a capital nature. Expenditure of a capital nature may only be deducted for taxation purposes if a special deduction provision exists. Section 15(b) of the Income Tax Act provides for a special deduction from income derived from mining operations of any prospecting expenditure incurred during the year of assessment.

4.3.4.1. Prospecting and evaluation expenditure

Section 15(b) of the Income Tax Act provides for a deduction from income derived from mining operations (see section 4.3.1 for a discussion on income derived from mining operations) of any prospecting expenditure incurred during the year of assessment. The prospecting expenditure incurred should relate to any area within the Republic of South Africa. The deduction includes expenditure on surveys, boreholes, trenches, pits and other prospecting work preliminary to the establishment of a mine and it also includes other expenditure that is incidental to the prospecting operations. However, the special deduction provision does not apply to expenditure of an initial nature (i.e. acquisition of land or prospecting rights) as this initial expenditure is of a capital nature (KPMG, 1993:8). There are three specific restrictions that apply to section 15(b) of the Income Tax Act:

- The instalment restriction: This restriction applies to all companies except diamond companies and it confers on the Commissioner the discretion to determine that the prospecting expenditure shall not be deducted in full but, instead, in a series of annual instalments.
- The class of mining restriction: This empowers the Commissioner to determine the class or classes of mining from which the deduction may be deducted and in such proportion as would be determined by the Commissioner.
- The capital redemption restriction: Prospecting expenditure deductible under section 15(b) of the Income Tax Act may not be deducted under the mining capital redemption allowance of section 36 of the Income Tax Act.

The question arises as to whether it is necessary that the taxpayer should conduct mining operations, (see section 4.3.1 for a discussion on the definition of mining operations) in order to be able to claim the section 15(b) of the Income Tax Act deduction. There are possibly two solutions to this problem. Firstly, all prospecting expenditure is carried forward to the year of commencement of production and deducted when mining income has been derived (KPMG, 1993:9) (Platmin Limited, 2010). However, even if it were argued that a junior exploration company was not conducting mining operations during the prospecting period, there is another argument in favour of the deduction of prospecting expenditure (Van Blerck, 1992:9–6). In *Sub-Nigel Ltd v CIR* (15 SATC 381) it was maintained that it is necessary only that expenditure be incurred for the purpose of producing income and the simple fact that income is not produced does not prohibit the deductibility of the expense. Therefore, it may be argued that, providing the taxpayer has the objective of establishing a mine in the future, the prospecting expenditure is being incurred for the purpose of producing income from mining operations in the future (Van Blerck, 1992:9–6). On this basis it may be argued that the prospecting expenditure should be carried forward in terms of the assessed loss provision. However, the Marais Committee (see section 4.2) commented on section 15(b) of the Income Tax Act and identified a problem in respect of prospectors who are prospecting to establish a mine but are not yet involved in mining operations. The problem would be that there is no mining income against which the deduction may be offset (Marais, 1988:204). The Marais Committee confirmed that junior exploration companies prospecting to establish a mine would be allowed to use the special deduction provision of section 15(b) of the Income Tax Act only once they had earned mining income. The Marais Committee also confirmed that the value of the deduction according to section 15(b) of the Income Tax Act is limited to the income against which the deduction may be offset. This confirms the fact that junior exploration companies would not be able to create an assessed loss with section 15(b) of the Income Tax Act and would be allowed to deduct exploration expenditure only once they had earned mining income.

4.3.4.2. Investment income

Exploration companies earn substantial amounts of interest on funds that are held pending the exploration programmes. Tax authorities and exploration companies regard such income as non-mining income (Van Blerck, 1992:10–3). The fact that interest earned by virtue of participating in a cash management scheme is classified as non-mining income was confirmed in *Western Platinum Limited v Commissioner for SARS (supra)*. Accordingly, junior exploration companies will not be able to deduct exploration expenditure against investment income, as

stipulated in section 15(b) of the Income Tax Act, as their investment income is classified as non-mining income.

4.3.4.3. Disposal of prospecting rights

Where the rights were originally acquired in order to establish a mine these rights were considered to be of a capital nature (see section 4.3.2). The mere fact that a taxpayer disposes of a capital asset at a profit is not sufficient evidence to conclude a change in intention and something more is required to indicate that the owner is engaged in a scheme of profit making (see section 4.3.2).

Section 37 of the Income Tax Act deals with the calculation of capital expenditure on the sale, transfer, lease or cession of mining property. For the purposes of this section in the Income Tax Act mining property refers either to any land on which mining is carried on or any right to minerals. As discussed in section 4.3.1, if a company is wholly involved in prospecting and exploration activities, then the activities of such a company do not constitute “mining operations”. The SARS views a mining property to be a mine that has achieved the production phase (Cronjé & Sturdy, 2010). Accordingly, prospecting activities alone do not constitute mining and do not meet the definition of the term “mining property”. As a result, section 37 of the Income Tax Act does not apply when a junior exploration company sells prospecting rights.

When a junior exploration company that is prospecting to establish a mine sells prospecting rights there will be capital gains tax consequences. Capital gains tax is typically paid when assets such as prospecting rights are sold (White Rivers Gold Ltd, 2010). In terms of the Eighth Schedule to the Income Tax Act, a capital gain or loss is calculated by deducting the base cost of the asset from the proceeds received. Only 50% of the capital gains are taxed (Platmin Limited, 2010).

4.3.5. Other tax matters relating to junior exploration companies

Other specific tax matters relating to junior exploration companies that could influence their taxation practices include the following:

4.3.5.1. Environmental contributions

According to the MPRDA a junior exploration company is obliged to make financial provision for the rehabilitation of the environmental impact of its activities. Section 37A of the Income Tax Act

allows a deduction from income of any cash paid during the year of assessment to a closure rehabilitation company or trust. The only objective of a closure rehabilitation company or trust is to apply its property solely for the rehabilitation of any latent and/or residual environmental impacts on areas covered in terms of any permit or right in respect of prospecting, exploration, mining or production as contemplated in the MPRDA. The distributions and assets of the closure rehabilitation company or trust are used solely for the purpose of rehabilitation. Section 37A of the Income Tax Act is applicable to cash paid on or after 2 November 2006. The Department of Mineral Resources (DMR) stopped junior exploration companies from using insurance firms to underwrite their rehabilitation obligations in favour of more expensive cash or bank guarantees (Seccombe, 2009). It appears as if the DMR favours cash or bank guarantees from junior exploration companies for their rehabilitation obligation, this could lead to junior exploration companies not being able to use section 37A of the Income Tax Act.

4.3.5.2. Mineral and Petroleum Resources Royalty Administration Act

According to section 2 of the Mineral and Petroleum Resources Royalty Administration Act 29 of 2008 (MPRRA) a person with a prospecting or exploration right granted pursuant to the MPRDA must also register with the Commissioner by 30 June 2009 or within 60 days after the person has qualified for registration. Junior exploration companies need to register even if the companies are not producing; a lot of junior exploration companies are not aware of this fact (Prinsloo, 2009).

4.3.5.3. Mineral and Petroleum Resources Royalty Act

The purpose of the Mineral and Petroleum Resources Royalty Act 28 of 2008 (MPRRA) is to enforce royalties on the extraction of the country's minerals. Although junior exploration companies are not involved in large-scale mining, nevertheless they do extract minerals for the purpose of analysis and sampling. Section 8 of the MPRRA specifies that an extractor is exempt from the royalty imposed in respect of mineral resources won or recovered by the extractor for the purposes of testing, identification, analysis and sampling mentioned pursuant to either a prospecting right or an exploration right if the gross sales in respect of those mineral resources does not exceed R100 000 during a year of assessment.

Section 7 of the MPRRA also includes a small business exemption in that this section stipulates that an extractor is exempt from the royalty in respect of a year of assessment if the gross sales of that extractor in respect of all mineral resources transferred does not exceed R10 million

during that year; the royalty in respect of all mineral resources transferred that would be imposed on the extractor for that year does not exceed R100 000; the extractor is a resident as defined in section 1 of the Income Tax Act throughout the year in question and the extractor is registered for that year pursuant to section 2 of the MPRRAA (see section 4.3.5.2 above).

4.4. VENTURE CAPITAL

One of the consequences of the introduction of the MPRDA was that a large number of junior exploration companies and investors applied for prospecting rights. This, in turn, introduced a number of junior exploration companies that prospect either for speculative purposes or to establish a mine. As discussed in section 4.3.4.1, if a junior exploration company is carrying out exploration work with the aim of establishing a mine, then the expenditure relating to the prospecting work is not tax deductible until mining income has been generated. This puts a junior exploration company seeking to establish a mine at a major disadvantage. In addition, as discussed in section 4.3.4.1, this problem has already been identified in the Marais Committee report in 1988. The Committee suggested that measures be initiated to allow the prospectors to benefit from tax deductions in respect of their cost and, thereby, to encourage prospecting (Marais, 1988:204). The Committee actually identified a possible solution to be investigated, namely, the Canadian concept of flow through shares (FTS) (Marais, 1988:204). The purpose of this section is to provide an overview of the tax policy introduced by the South African government to boost exploration and attract investors for junior exploration companies.

Junior exploration and mining companies in South Africa have repeatedly complained about the problems they run into in attaining finance as local investors have little appetite for exploration risk (Creamer, 2009). Since the 1988 recommendations of the Marais Committee report no further investigation has been done regarding the FTS concept. In 2006 the trade commissioner at the Canadian High Commission in Johannesburg conducted a road show introducing the concept of FTS (Smuts, 2006:28). It was the belief of various role players that a mechanism such as the FTS scheme would create a significant source of funding for exploration companies (Smuts, 2006:27). Figure 4.2 illustrates the FTS scheme.

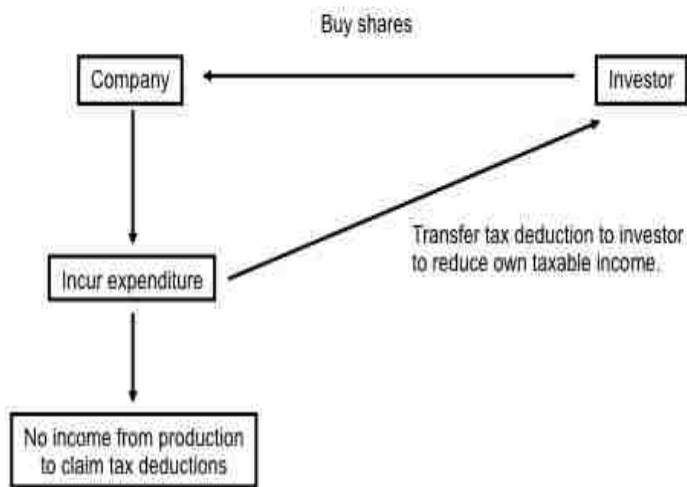


Figure 4.2: Flow Through Shares scheme

Source: Own observation

The FTS scheme allows a company to relinquish certain expenditure to the purchaser of the share (Smuts, 2006:27). Such expenses will be deemed to have been incurred by the investor and not the company. This, in turn, allows the costs to be claimed earlier than they would have been if they had been kept in the company (Smuts, 2006:27). In the budget speech of 2007 by the Minister of Finance the Minister maintained that the government was looking into the Canadian FTS scheme in order to encourage investment in junior mineral exploration companies (Manual, 2007). A National Treasury-chaired working group was established to examine the possible benefits of a FTS scheme (Creamer, 2009). The top priority of the National Treasury was to investigate the cost of such a scheme to the fiscus (Seccombe, 2007). The National Treasury working group found that the FTS scheme would be “an administrative nightmare” (Creamer, 2009). Accordingly, in view of the fact that a FTS scheme would result in too much paperwork for the South African Revenue Services (SARS), SARS decided to investigate other possible schemes to encourage investment.

Section 12J was added to the Income Tax Act to create an incentive to invest in junior exploration companies. This section deals with deductions relating to expenditure incurred in exchange for the issue of venture capital company (VCC) shares. The intention of section 12J of the Income Tax Act is to provide a tax incentive for investors in both small and medium sized enterprises and junior mining exploration companies in South Africa (Camay, 2008). Figure 4.3 illustrates the way in which section 12J works.

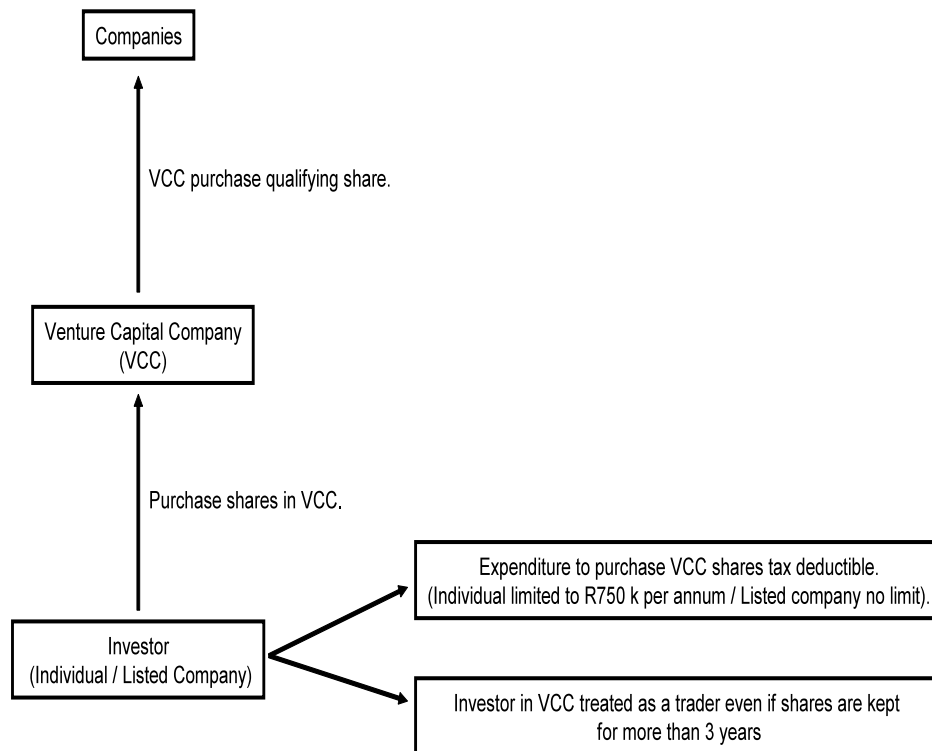


Figure 4.3: Section 12J (venture capital company)

Source: Own observation.

According to the definition of a junior mining company, in terms of section 12J of the Income Tax Act, a junior mining company refers to any company that is solely carrying on a trade of mining exploration or production and which is either an unlisted company or listed on the alternative exchange of the Johannesburg Securities Exchange (JSE). Section 12J of the Income Tax Act does not specifically have any influence on the tax practices of junior exploration companies although it does create an incentive to encourage investment in junior exploration companies.

4.5. SUMMARY AND CONCLUSION

With the change in the mineral policy of South Africa a large number of junior exploration companies penetrated the mining industry. The business of exploration is a high risk, time consuming and costly exercise. The intention of these junior exploration companies may either be speculative or the establishment of a mine. The Income Tax Act contains specific provisions that apply to prospecting expenditure incurred by taxpayers who derive income from mining operations. Junior exploration companies are involved exclusively in basic prospecting and exploration and do not engage in mining operations. The junior exploration company with a speculative intention is allowed to deduct from its income the prospecting expenditure that was

incurred in the production of income and which is not of a capital nature. However, junior exploration companies that are carrying out exploration work in order to establish a mine are at a major disadvantage as the expenditure relating to prospecting work is not tax deductible until mining income has been generated. The Income Tax Act does not address the treatment of prospecting expenditure incurred by junior exploration companies and this could lead to various interpretations by junior exploration companies in the taxation treatment of prospecting expenditure.

The Income Tax Act allows a deduction from income of any cash paid during the year of assessment to a closure rehabilitation company or trust, but the DMR favours cash or bank guarantees for the rehabilitation liability of junior exploration companies. This practice of the DMR could lead to junior exploration companies not using the special deduction provision in section 37A of the Income Tax Act. The MPRRAA requires junior exploration companies to register if they are in possession of a prospecting right, but it seems not all junior exploration companies are aware of this requirement which could lead to non-compliance of the MPRRAA.

Section 12J was added to the Income Tax Act to create an incentive to invest in junior exploration companies. However, it is fairly restrictive and includes various mandatory regulations. Although this amendment has no tax influence on junior exploration companies it could encourage investment in exploration companies. The following chapter discusses the research methodology adopted in this study.

CHAPTER 5

RESEARCH METHODOLOGY

5.1 INTRODUCTION

Methodology refers to the strategy which the researcher adopts in mapping out an approach to either problem finding or problem-solving (Buckley, Buckley & Chiang, 1976:14). However before describing the methodology of this study it is necessary to define the research objective.

Chapter 2 discussed the change in the mineral policy of South Africa which led to a significant increase in the number of junior exploration companies while chapter 3 focused on the lack of uniformity and acceptable accounting practices in respect of the extractive industries, despite the issue of the International Financial Reporting Standard IFRS 6 (IASB, 2010a), *Exploration for and evaluation of mineral resources*. Chapter 4 highlighted the fact that the Income Tax Act does not include a definition of either prospecting or exploration. It was also determined that the activities of a company that is involved entirely in prospecting and exploration activities do not constitute mining operations and that such companies may, therefore, utilise the special deductions in the Income Tax Act only once they have generated mining income.

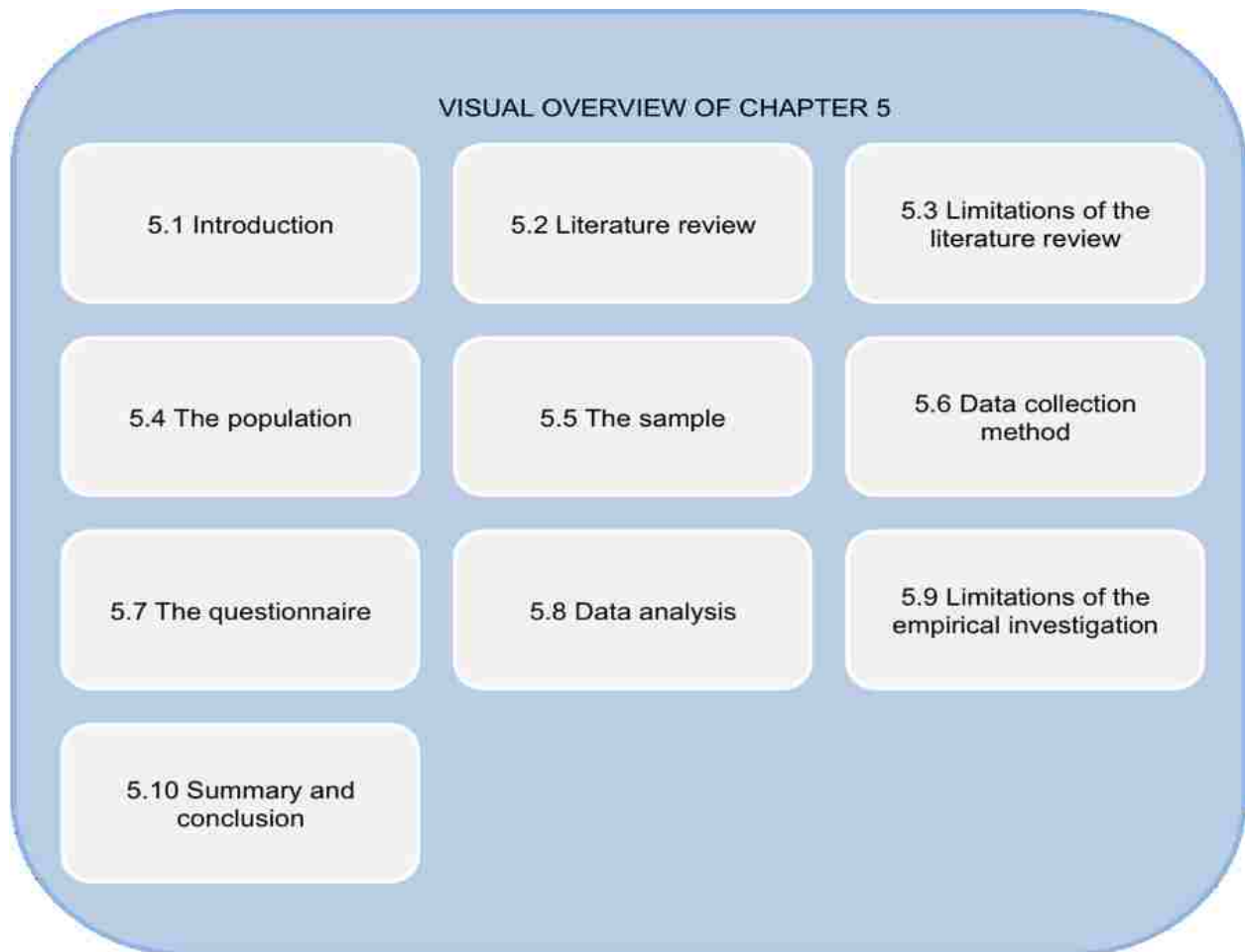
The objective of the study was to perform a literature review and to carry out empirical research by using questionnaires that were distributed to junior exploration companies to investigate whether accounting and taxation practices are consistently applied.

The three main characteristics of accounting research are reliability, validity and established theory (Smith, 2003:39). These three main characteristics may be defined as follows (Smith, 2003:40):

- “Reliability establishes the consistency of a research instrument in that the results it achieves should be similar in similar circumstances.” The research instrument used in this study was a questionnaire and the results achieved with the questionnaire should be similar in similar circumstances.
- “Validity measures the degree to which our research achieves what it sets out to do.” The research achieved what it sets out to do, by investigating whether accounting and taxation practices by junior exploration companies are consistently applied.

- “Theory is a network of hypotheses or an all-embracing notion that underpins one or more hypotheses.” The hypothesis of this study is that junior exploration companies do not consistently apply accounting and taxation practices. A proven hypothesis establishes theory.

The purpose of this chapter is to present an outline of the research methods used to ensure that the main characteristics of accounting research are adhered to in this research project. The methodology used in this study was a literature study and self-administered questionnaire, that is, a web-based survey used to collect the respondents’ answers to the questionnaire. The layout of this chapter is as follows:



5.2 LITERATURE REVIEW

Mouton (2005:86) maintains, “... it is essential that every research project begins with a review of the existing literature.” Mouton (2005:87) then proceeds to present a number of reasons why

a literature review is important. In terms of this research study these reasons include the following:

- To ensure that this research project is not merely a duplication of a previous study. In other words, that this is the first study that combines the new mineral policy with the accounting and taxation practices that relate to junior exploration companies.
- To uncover the most recent and authoritative theorising on the subject. The lack of uniformity and acceptable accounting practices in the extractive industry has already been identified and the IASB issued a DP (IASB, 2010b) on extractive activities in April 2010. In addition, the 1988 Marais Committee (Marais, 1988) has already identified the disadvantages pertaining to exploration companies in relation to the provisions in the Income Tax Act. Section 12J was introduced into the Income Tax Act in 2009 in order to create a taxation system which would boost exploration in South Africa.

This literature review concentrated on the accounting and taxation interpretations that influence junior exploration companies in South Africa. The main sources of information for the literature review were published text at the library of the University of South Africa, International Financial Reporting Standards (IFRSs), the South African Income Tax Act no 58 of 1962 and internet websites.

5.3 LIMITATIONS OF THE LITERATURE REVIEW

The literature review includes accounting policies and practices for exploration expenditure in the mining industry; the literature does not distinguish between junior exploration companies and mining companies. The extent of literature available on the South African taxation practices of junior exploration companies are limited and dates mainly back to the early 1990's. The literature available on accounting and taxation practices of junior exploration companies is therefore a limitation of this study that emphasises its contribution to extend the limited body of knowledge on which future research could build.

5.4 THE POPULATION

The aim of this research study was to investigate whether accounting and taxation practices of junior exploration companies in South Africa are consistently applied. Junior exploration companies are not involved in mining and will, therefore, be in possession of prospecting rights only. In May 2009, the Department of Minerals and Energy (DME) was divided into the Department of Mineral Resources (DMR) and the Department of Energy. The researcher

obtained a list of issued prospecting rights from the Mineral Regulation branch of the DMR on 22 September 2009. This list contains the details of all prospecting rights that had been issued before 22 September 2009. A mining rights list was obtained from the Mineral Regulation branch of the DMR on 25 September 2009. There were 4 267 prospecting rights and 396 mining rights in issue. Both lists contained the names of the holders of these prospecting and mining rights. The majority of the holders of the rights were private companies, close corporations, individuals and public companies. The researcher categorised the lists according to the holders of the rights. If the researcher was unsure of the category of the holder of a right a search for the holder's name was carried out on the website of the Companies and Intellectual Properties Registration Office (CIPRO). The researcher compared the prospecting rights list and the mining rights list and, if a holder's name was on both lists, the name was removed from the prospecting rights list. This was done to ensure that the holders of prospecting rights were not in possession of a mining right. Excluding the holders of mining rights there were 3 625 prospecting rights in issue at that time. Table 5.1 depicts the ownership categories of the 3 625 prospecting rights.

Table 5.1: Holders of prospecting rights only

Holder of prospecting rights	Number of rights
Private companies ((Pty) Ltd)	2 428
Close corporations (CC)	482
Individuals	390
Public companies (Ltd)	228
Other	97
Total	3 625

The target population should comprise everyone of interest who could possibly be included in a research study and to which the research findings may reasonably be generalised (Czaja & Blair, 2005:130). This study focused on the accounting and taxation practices of junior exploration companies and, thus, the prospecting rights held by CCs, individuals and others were not included in the study. The target population thus comprised of private companies and public companies as the holders of the prospecting rights. The total number of prospecting rights held by the target population amounted to 2 656. The target population of these 2 656 prospecting rights were held by 49 public companies and 1 117 private companies as individual companies held between one and more than twenty prospecting rights each. Table 5.2 presents

a breakdown of the prospecting rights held by the target population and indicates the number of prospecting rights held by the 49 public companies and 1 117 private companies respectively.

Table 5.2: Breakdown of number of prospecting rights

Number of prospecting rights	Number of public companies	Number of private companies
One right	21	692
Two rights	6	188
3–5 rights	11	159
6–10 rights	6	56
11–20 rights	2	19
> 20 rights	3	3
Total	49	1 117

As indicated in Table 5.2 the majority of companies are in possession of one prospecting right only.

5.5 THE SAMPLE

A sample is the portion of the population that is selected for a study. This study will use purposive, non-probability sampling. In non-probability sampling there is no guarantee that each element in the population will be represented in the sample (Leedy, 1988:152). However, it is important in purposive sampling that the respondents in the study have the necessary common experience that will result in useful research data (Kolb, 2008:112). Accordingly, a research study will be effective only if the right respondents are selected. In this study the researcher employed the expert sampling method which is also known as the judgement sampling method. Judgement sampling is a subdivision of purposive sampling that involves identifying those respondents who are likely to provide certain information (Strasheim, 2009).

The researcher originally chose the 49 public companies in the population as the sample. The researcher is of the opinion that public companies are more likely to have a dedicated person in management who will be responsible for the financial reporting and taxation of the company and who will be able to answer questions relating to both the application of IFRS 6 (IASB, 2010a) in the company as well as the application of the Income Tax Act in the company. The researcher performed a breakdown of the public companies by year of registration, as per their company

registration numbers. The company registration numbers had been obtained from the application contact list in the DMR national mining promotion system. Table 5.3 depicts a breakdown of the public companies by year of registration, as per their company registration number.

Table 5.3: Breakdown of public company registration dates

Company registration dates	Number of public companies
Before the year 1980	19
Between years 1980–1999	18
Between years 2000–2003	7
After the year 2003	5
Total	49

The majority of public companies had registration numbers prior to the year 2003. The aim of this research study was to determine whether accounting and taxation practices of junior exploration companies in South Africa are consistently applied. With the promulgation of the MPRDA in May 2004 the opportunity arose for a significant number of new role players to enter the extractive industry in South Africa. As mentioned above this research study will be effective only if the right respondents are selected. The researcher wished to focus on the new role players that had entered the extractive industry in South Africa as a result of the change in the mineral policy of South Africa in May 2004. Accordingly, the researcher decided that the sample would comprise all companies with registration dates after 2003. However, this involved looking up the registration numbers of the 1 117 private companies in the population. Therefore, in view of the time constraints, the sample selected in this study comprised all companies with registration dates after 2003 with more than five prospecting rights each. The expectation of the researcher was that the probability was higher that companies with a greater number of prospecting rights would have actively exploited one or more of their rights and would, thus, be in a position to provide the information required by this study. Table 5.4 presents a breakdown, by year of registration, as per their company registration number, of those companies with more than five prospecting rights.

Table 5.4: Breakdown of company registration dates of companies with more than five prospecting rights each

Company registration dates	Number of public companies	Number of private companies
Before the year 2000	7	7
Between years 2000–2003	2	15
After the year 2003	2	56
Total	11	78

It is clear from Table 5.4 that, with the change in the mineral policy of South Africa in 2004, the opportunity for new role players to enter the mining arena increased significantly. There was a marked increase in the number of private companies with more than five prospecting rights with company registration dates after the year 2003. The sample selected for this study comprises companies with more than five prospecting rights each and with company registration dates after the year 2003. This sample ensured that the researcher obtained the information for the study from the new role players in the extractive industry that were involved solely in exploration. Accordingly, the sample comprised two public companies and 56 private companies. This total of 58 companies selected for the sample held a total of 542 prospecting rights between them.

5.6 DATA COLLECTION METHOD

This study involved a self-administered survey with a web-based survey being used to collect the data. The advantages of web-based surveys include the following: the data capturing may be fully automated, a short turn-around of results and web survey services are readily available (Alreck & Settle, 2004:183). Another benefit of conducting a survey is that the researcher is able to compare responses as each respondent is asked the same questions (Kolb, 2008:30). LimeSurvey was the survey tool used. The Bureau of Market Research at UNISA entered the questions on the survey tool and administered the web survey on behalf of the researcher.

Interaction with survey respondents may be divided into three main components, namely, contact, response and follow up (Schonlau, Fricker & Elliot, 2002). The researcher obtained a list from the DMR containing the contact details of all companies in possession of prospecting rights. The researcher commenced by contacting the 58 companies that comprised the sample telephonically and obtaining the email addresses of those persons in management accountable

for the companies' compliance with IFRS and with the Income Tax Act. The researcher then contacted the specific respondents by way of an email invitation to participate in the survey. The invitation is presented in Appendix A to this study. The link to access the web-based survey was included in the email invitation. If the researcher was unable to contact the company using the contact numbers provided by the DMR the email invitation to participate in the survey was sent to the email address as per the DMR contact list. The web-based survey collected the responses of the respondents. A record of all the responses was kept for follow up purposes. This enabled the researcher to remind those companies that had not responded to the first email to respond. Two follow-up reminders were emailed to the respondents. Table 5.5 presents a summary of the possible respondents in the survey. Of the total sample of 58 it was not possible to contact five respondents because of the fact that the contact numbers either did not exist or else the contact details as per the DMR contact list were incorrect. Four emails bounced back because the emails address as per the DMR contact list did not exist. Fifteen companies indicated that they would be unable to respond for various reasons. This meant that 34 responses could be expected.

Table 5.5: Summary of respondents

Sample size	58
Less: respondents with old or incorrect contact details as per the DMR contact list	(5)
Emails that bounced back	(4)
Companies not prepared to respond	(15)
Responses that could be expected	<u>34</u>

Fifteen companies had indicated that they would be unable to respond for various reasons, for example, the company was dormant, the company had not started with exploration, etc. Table 5.6 presents a breakdown of the reasons why the fifteen companies were not able to respond.

Table 5.6: Breakdown of reasons for not responding

Reasons why companies were not prepared to respond	Number
Dormant company	3
No or minimum exploration work carried out to date	4
Exploration work carried out by another company	5
Policy not to participate	1
Did not have resources to participate	<u>2</u>
Companies not prepared to respond	<u>15</u>

Of the 34 responses that could be expected, eleven junior exploration companies completed the questionnaire which equates to a response rate of 32% (11/34) of the responses that could have been expected and 19% (11/58) of the total sample size. The researcher employed the judgement sampling method in terms of which the sample does not, in fact, guarantee representativeness of the population. Although only eleven junior exploration companies participated in the survey the information gathered showed that junior exploration companies employed various accounting and taxation practices. However, this was an exploratory study and the results of the empirical investigation would not be generalised to the population.

5.7 THE QUESTIONNAIRE

The questionnaire was compiled on the basis of accounting standards and taxation legislation interpretations affecting junior exploration companies. The questionnaire was mainly a structured questionnaire that specified alternatives for the respondents. As such the questionnaire consisted mainly of dichotomous choice and multiple-choice questions. A dichotomous choice question allows the respondent to choose one of two responses that are usually opposite with an example being answers to which the respondent would tick either yes or no (Kolb, 2008:202). Multiple-choice questions are used when the researcher has a number of variables that may affect the choice of the respondent (Kolb, 2008:202). The multiple-choice questions in this questionnaire allowed the respondent to determine one answer only that best described or was true.

The web-based survey questionnaire is presented in Appendix B to this study. The questionnaire consisted of biographical information and three further sections. The questionnaire commenced with biographical questions which were aimed at obtaining background information in respect of both the company concerned and the person completing the survey. Section 1 of

the questionnaire aimed to establish the response to the recommendations made by the project team of the DP (IASB, 2010b) on extractive activities and which was issued in April 2010 by the International Accounting Standards Board (IASB). The various questionnaire items in section 1 were evaluated on a 4-point Likert scale. The 4-point Likert scale used was as follows:

- S/D Strongly disagree
- D Disagree
- A Agree
- S/A Strongly agree

Respondents were requested to indicate on a scale rating the extent to which they agreed with the recommendations made by the project team of the DP on extractive activities (IASB, 2010b). Section 2 of the questionnaire aimed, firstly, to establish the different accounting practices implemented by the junior exploration companies in the accounting of pre-exploration and exploration and evaluation expenditure and, secondly, to evaluate these junior exploration companies' accounting treatment of exploration and evaluation costs according to IFRS 6 (IASB, 2010a). The scaling formats used in section 2 of the questionnaire are mainly determinant choice and dichotomy. Section 3 of the questionnaire aimed to investigate the tax consequence of the exploration and evaluation costs in respect of those junior exploration companies that are not yet involved in mining activities. The scaling formats used in section 3 of the questionnaire are mainly determinant choice and dichotomy.

In order to demonstrate that the survey instrument is capable of generating the responses required it is essential that pilot testing of the survey instrument be carried out (Smith, 2003:122). When testing the survey both the questions themselves and their wording should be examined as well as the content of the questions (Kolb, 2008:198). The possible answers to the closed ended questions should be examined in order to ensure they include the answers which most respondents would provide (Kolb, 2008:198). Although surveys are often tested on academic colleagues it helps if a member of the population who is not part of the sample is used to test the survey instrument (Smith, 2003:122). Academic colleagues and one financial manager from a junior exploration company that formed part of the population tested the questionnaire as did a financial manager from a listed mining and exploration company. A pilot study generally improves the reliability and validity of individual questions in a questionnaire (Smith, 2003:122).

5.8 DATA ANALYSIS

The survey tool used was LimeSurvey. This survey tool was used to generate the statistics for the questionnaire. The statistical output options may be viewed in graphs and tables with the output format being HTML, PDF or Excel.

5.9 LIMITATIONS OF THE EMPIRICAL INVESTIGATION

The details used to determine both the population and the sample for this study were obtained from the lists drawn up by the DMR. Accordingly, if the information on these lists from the DMR were either incomplete or incorrect this would mean that the population and the sample used in this study might be inaccurate. Therefore the results of the survey was not generalised to the population.

The sample selected in this study comprised, firstly, all companies in possession of more than five prospecting rights each and, secondly, companies with registration dates after the year 2003. Thus, the sample does not guarantee representativeness of the population with the population being junior exploration companies or companies involved in exploration activities only. Therefore the results of the survey was not generalised to the population.

Most of the companies involved in exploration activities are private companies. Many of these private companies prepare financial statements for compliance purposes only or for the providers of the funding for their exploration activities. Such companies could rely on either external auditors or contractors to finalise their financial statements and taxation returns if they do not have the expertise in the company. This could result in lack of knowledge of both IFRS and taxation on the part of many of these private companies and could effect the accuracy of the data obtained from the questionnaire.

Exploration work is time consuming, extremely costly and high risk. Private companies may have obtained the prospecting rights but they do not necessarily have the funding to start the exploration work or else are dormant because of unsuccessful exploration results. This resulted in a lack of available information regarding the accounting and taxation practices of junior exploration companies. This also resulted in a lower response rate to the questionnaire.

The majority of companies in the sample are private companies. The contact list of the DMR was used to contact the companies via telephone or email. The researcher was unable to contact

some of the respondents as a result of incorrect contact details or numbers no longer in use. If the researcher was unable to contact a company that company was not invited to participate in the survey and resulted in lower response rate to the questionnaire.

5.10 SUMMARY AND CONCLUSION

The methodology used in this study was a literature study and self-administered questionnaire with a web-based survey being used to collect the respondents' answers to the questionnaire. The survey tool used was LimeSurvey and the Bureau of Market Research at UNISA assisted the researcher in the use of the survey tool.

The researcher employed the expert sampling method which is also known as the judgement sampling method. Judgement sampling is a subdivision of purposive sampling and involves identifying those respondents who are likely to provide certain information. The researcher wanted to obtain the information for the study from the new role players in the extractive industry and which were involved solely in exploration. Accordingly, the sample selected for this study comprised companies in possession of more than five prospecting rights each and with company registration dates after the year 2003. An email was send to these companies inviting the financial director, financial manager or accountant of the company to participate in the study. The link to access the web-based survey was included in the email invitation.

The total sample comprised 58 companies although 34 responses only were expected. Of the 34 responses expected eleven companies actually responded. As noted earlier, the small sample size and other limitations may hinder the interpretation of the empirical findings. However, this is an exploratory study and the results of the empirical investigation will not be generalised to the population of the study. In the next chapter the findings of the empirical investigation are analysed and interpreted.

CHAPTER 6

RESEARCH RESULTS

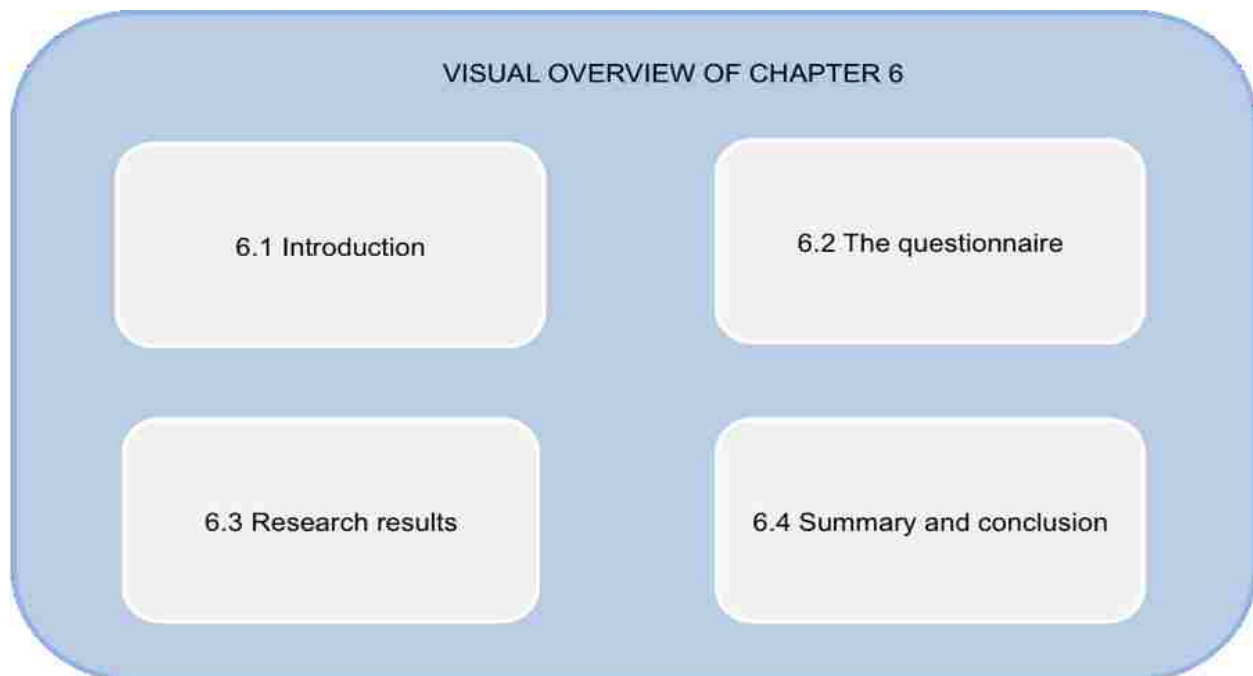
6.1 INTRODUCTION

The lack in uniformity of acceptable accounting practices in the extractive industries has long been recognised. Even with the issue of the International Financial Reporting Standard IFRS 6 (IASB, 2010a), *Exploration for and evaluation of mineral resources*, there are still various accounting interpretations and practices relating to the accounting for exploration and evaluation expenditure.

The change in the mineral policy of South Africa led to a significant increase in the number of junior exploration companies. The researcher involved the new role players, which had entered the extractive industry in South Africa. The companies selected to participate in the web-based survey comprised companies in possession of more than five prospecting rights and with company registration numbers after the year 2003.

The objective of the study was to investigate whether accounting and taxation practices of junior exploration companies are consistently applied. The purpose of the questionnaire was, firstly, to receive comment on the DP (IASB, 2010b) on extractive industries issued by the IASB as the recommendations made by the DP (IASB, 2010b) could influence future accounting practices of junior exploration companies. Secondly, to establish the accounting policies and the treatment of exploration and evaluation costs according to IFRS 6 (IASB, 2010a) of the junior exploration companies in order to determine whether the accounting practices of junior exploration companies are consistently applied. Lastly, to establish the taxation treatment of exploration and evaluation costs by junior exploration companies in order to determine whether the taxation practices are consistently applied. This chapter covers the responses received from the web-based survey.

The layout of this chapter is as follows:



6.2 THE QUESTIONNAIRE

The total population of companies, as per the list obtained from the Department of Mineral Resources (DMR) in September 2009, that are involved solely in exploration activities comprises 49 public companies and 1 117 private companies (see section. 5.4 for a discussion on the population of this study).

The companies selected to participate in the web-based survey were companies with more than five prospecting rights each and with company registration numbers after the year 2003. A total of 58 companies were selected to participate in the study. Of this total sample of 58, it was not possible to contact nine respondents while fifteen companies indicated that they were unable to respond. (See paragraph 5.6 for details of reasons why respondents were unable to respond.) This meant that 34 responses could be expected. Eleven of the possible 34 responses completed the questionnaire; therefore the response rate of the survey was 32% (11/34). Five of the eleven responses represented a group of companies with the same management and same policies and practices. The researcher employed the judgement sampling method and, thus, the sample does not guarantee representativeness of the population. However, this is an exploratory study and the results of the empirical investigation will not be generalised to the population.

The responses of companies that participated in the survey are presented in the following section.

6.3 RESEARCH RESULTS

The questionnaire consisted of biographical information and three sections (refer to Appendix B for details). The results of the questionnaire are presented per section with the statement or question being displayed with the results set out in a table and with a conclusion. **Question 1** of the survey requested the consent of the respondents while **question 2** required the respondents to furnish the names of their companies. It was, however, not mandatory to answer question 2.

6.3.1. Biographical section

Question 3: *What best describes your position in the company?*

This response provides background information as to who in the company responded to the survey.

Table 6.1: Question 3

Multiple-choice	Frequency	%
Chief Executive Officer/Managing director	0	0,0
Chief Financial Officer	5	45,4
Financial Manager	2	18,2
Accountant	2	18,2
Other	2	18,2
Total	11	100,0

All the respondents were involved in the accounting function of the companies concerned, whereby 45,4% of the respondents were the chief financial officer, 18,2% the financial manager and 18,2% the accountant of the company. Those respondents who chose “other” indicated that their positions were that of either bookkeeper or financial controller.

Question 4: *How many full time employees are currently employed by the company?*

The responses to this question provided background information on the size of the company.

Table 6.2: Question 4

Multiple-choice	Frequency	%
1–10 employees	3	27,3
11–25 employees	2	18,2
26–50 employees	1	9,0
50 + employees	5	45,5
None	0	0,0
Total	11	100,0

Of the respondents, 45,5% have more than 50 employees. The 45,5% represent a group of five companies with the same management. It is possible that the group as a whole has more than 50 employees and not each individual company in the group. Table 6.2 indicates that 27,3% of the respondents have less than 10 employees, while 18,2% have between 11 and 25 employees and 9% have between 26 and 50 employees.

Question 5: *How many years has the company been trading or been in business?*

This response could confirm that companies that participated in the survey were new role players in the extractive industry and had come into being as a result of the change in the mineral law of South Africa.

Table 6.3: Question 5

Multiple-choice	Frequency	%
Less than 1 year	0	0,0
1–2 years	0	0,0
3–5 years	10	90,9
5–10 years	1	9,1
10 + years	0	0,0
Total	11	100,0

The majority of companies (90,9%) that participated in the survey had been in business for between three and five years and 9,1% of the respondents had been trading between five and

10 years. This confirmed that the respondents in the survey were new role players in the extractive industry.

6.3.2. New IFRS developments (DP on extractive activities) section

This section of the questionnaire was aimed at determining a response to the recommendations made by the project team of the DP (IASB, 2010b) on extractive activities issued in April 2010 by the International Accounting Standards Board (IASB). The various questionnaire items in this section were evaluated on a 4-point Likert scale.

6.3.2.1. Scope and approach of extractive activities IFRS

The scope of this DP encompasses the financial reporting issue relating to the exploration for and the finding of minerals or oil and natural gas deposits, the developing of these deposits and the extracting of the minerals or oil and natural gas (IASB, 2010b:15). These activities may be referred to as extractive activities or upstream activities (IASB, 2010b:15).

Question 6: Scope and approach of extractive activities IFRS.

The proposed scope (IASB, 2010b:15) of the DP includes exploration for mineral or oil and gas deposits as well as the extraction and development of these deposits. The DP (IASB, 2010b:15) also proposes a single accounting and disclosure model for the oil and gas industry as well as the minerals industry.

Table 6.4: Question 6

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>The scope of extractive activities – IFRS should include upstream activities for mineral, oil and natural gas only.</i>	0	0,0	3	27,3	8	72,7	0	0,0	11
<i>There should be a single accounting and disclosure model that applies to both the mineral industry and to the oil and gas industry.</i>	0	0,0	2	18,2	8	72,7	1	9,1	11

Table 6.4 confirms that 72,7% of the respondents were in agreement that one IFRS should govern the accounting for the upstream activities of the oil and gas industry as well as the minerals industry, while 27,3% disagreed. 18,2% of the respondents disagreed with the recommendation made by the DP, that one accounting and disclosure model should be implemented for the oil and gas industry as well as the minerals industry, while 81,1% of the respondents (72,7% + 9,1%) agreed.

6.3.2.2. Definitions of reserves and resources

The most significant asset of most entities involved in the extractive industry is their reserves and resources. The definitions used for reserves and resources in different countries and in different industries may vary (IASB, 2010b:46).

Question 7: Definitions of reserves and resources.

Table 6.5: Question 7

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>The definitions of mineral reserves and resources, as established by the Committee of Mineral Reserve International Reporting Standards (CRIRSCO), should be used in an IFRS for extractive activities.</i>	0	0,0	0	0,0	4	36,4	7	63,6	11
<i>The definitions of oil and gas reserves and resources established by the Society of Petroleum Engineers should be used in an IFRS for extractive activities.</i>	0	0,0	0	0,0	4	36,4	7	63,6	11

One hundred percent of the respondents agreed with this recommendation with 63,6% strongly agreeing with the proposal of the DP to use the definitions for mineral reserves and resources as established by CRIRSCO and definitions for oil and gas reserves and resources as established by Society of Petroleum Engineers.

6.3.2.3. Mineral or oil and gas asset recognition model

Question 8 deals with the recommendations made by the DP regarding the mineral or oil and gas asset recognition model (IASB, 2010b:9). The main aim of accounting for extractive activities is to identify the point at which to recognise the asset that will develop over time as the extractive activities progress (IASB, 2010b:47).

Question 8: Mineral or oil and gas asset recognition model.

Table 6.6: Question 8

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>The mineral or oil and gas property (asset) is recognised when the legal rights (prospecting rights) are acquired.</i>	0	0,0	0	0,0	9	81,8	2	18,2	11
<i>The information obtained as a result of both subsequent exploration and evaluation activities and development works undertaken in order to access minerals or oil and gas deposits should be treated as an enhancement of the asset concerned.</i>	0	0,0	1	9,1	8	72,7	2	18,2	11
<i>The initial unit of account for the asset should be defined according to the geographical area in respect of which the prospecting rights are held.</i>	0	0,0	5	45,5	6	54,5	0	0,0	11

One hundred percent of the respondents agreed with this recommendation of the DP with 81,8% agreeing and 18,2% strongly agreeing that the legal rights form the basis of mineral or oil and gas assets. Table 6.6 also indicates that 90,9% (72,7% + 18,2%) of the respondents agreed that the exploration activities undertaken after the legal right had been obtained enhanced the

mineral or oil and gas property, while 9,1% disagree. In other words, these activities increase the value of the mineral or oil and gas property.

The unit of account will become smaller as exploration activities are undertaken and more information regarding the mineral or oil and gas properties is obtained (IASB, 2010b:9). Table 6.6 indicates that 54,5% of the respondents agreed that the geographical area as suggested by the DP should define the initial unit of account. The 45,5% of the respondents that disagreed represented the five companies that were part of the same group of companies. However, all of the other respondents agreed with the proposed unit of account for the asset.

6.3.2.4. Mineral or oil and gas asset measurement model

Question 9: Mineral or oil and gas asset measurement model.

The two main measurement bases used in financial accounting are historical cost or current value (IASB, 2010b:9).

Table 6.7: Question 9

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>The asset should be measured at historical cost.</i>	5	45,5	0	0,0	3	27,3	3	27,3	11

Table 6.7 indicates that 54,6% (27,3% + 27,3%) of the respondents agreed with the recommendation of the DP that the measurement model for the mineral or oil and gas property should be at historical cost. The 45,5% of the respondents that strongly disagreed represents the five companies that were part of the same group of companies.

6.3.2.5. Impairment of mineral or oil and gas asset

The DP actually proposes (IASB, 2010b:10) that the mineral or oil and gas asset not be tested for impairment according to IAS 36 (IASB, 2010a) but proposes that the mineral or oil and gas asset should be written down only when management has enough information to make that determination. Because this information is not likely to be available for most exploration properties while exploration and evaluation activities are continuing, the DP recommends that,

for those exploration assets, management should write down an exploration asset only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full (IASB, 2010b:10) .

Question 10: Impairment of mineral or oil and gas asset.

Table 6.8: Question 10

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>The asset should be written down to its recoverable amount in those cases in which management has sufficient information at its disposal to make this determination.</i>	0	0,0	0	0,0	4	36,4	7	63,6	11
<i>When information is not available management should write down the asset only when, in the judgement of management, there is a strong likelihood that the carrying amount will not be recoverable in full.</i>	0	0,0	0	0,0	4	36,4	7	63,6	11

All of the respondents agreed with the DP proposal with 63,6% strongly agreeing that the asset should be written down only when management has enough information to make that decision.

Table 6.8 indicates that all of the respondents agreed that, when information is not available to assist management in determining the recoverable amount of the mineral or oil and gas

property, management should use its judgement to determine whether the carrying amount is recoverable.

6.3.2.6. Mineral or oil and gas asset disclosure

The most significant asset of an entity involved in exploration is that entity's reserves and resources. The disclosure relating to reserves and resources in the financial reports of entities involved in exploration will constitute important information for the users of those financial reports. Question 11 in the survey deals with the proposed disclosure objectives (IASB, 2010b:10) of an IFRS in respect of extractive activities. These proposed objectives should enable the users of financial reports to evaluate the value of the mineral or oil and gas assets as well as the contribution to performance and the nature and risks associated with these assets.

Question 12 deals with the proposed disclosure (IASB, 2010b:11) of the most significant assets of companies in the extractive industry, namely, reserves and resources. The DP (IASB, 2010b:11) on extractive industries proposes disclosure only of information regarding reserve quantities and not resources. (See paragraph 3.3 of this study for detailed definitions of resources and reserves.)

The two main measurement bases used in financial accounting are either historical cost or current value, also known as fair value. As discussed above in question 9 the DP (IASB, 2010b) proposes that the historical cost method be used for the measurement of mineral or oil and gas assets. The DP further proposes that the current value measurements that correspond to the reserve quantities be disclosed in the financial reports (IASB, 2010b:11). Question 13 deals with the proposed information regarding the current value measurements of reserve quantities.

The DP also proposes the disclosure of other types of information (IASB, 2010b:11). Question 14 deals with the proposed other information that should be disclosed.

Question 11: *Disclosure objectives for an IFRS for extractive activities should enable users of financial reports to evaluate.*

Table 6.9: Question 11

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>A disclosure objective of an IFRS for extractive activities should be to enable the users of financial reports to evaluate (as stated in the DP) the value of an entity's mineral or oil and gas property (asset).</i>	1	9,1	0	0,0	8	72,7	2	18,2	11
<i>A disclosure objective of an IFRS for extractive activities should be to enable the users of financial reports to evaluate the contribution of the mineral or oil and gas assets of an entity to current performance of that entity.</i>	0	0,0	0	0,0	9	81,2	2	18,2	11
<i>A disclosure objective of an IFRS for extractive activities should be to enable the users of the financial reports of an entity to evaluate the nature and extent of risks</i>	0	0,0	0	0,0	9	81,2	2	18,2	11

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
<i>and uncertainties associated with the mineral or oil and gas asset of that entity.</i>									

Table 6.9 indicates that 90,9% (72,7% + 18,2%) of the respondents agreed, while 9,1% strongly disagreed, with a disclosure objective that would enable the users of financial reports to evaluate the value of the mineral or oil and gas asset of an entity involved in the extractive industry. It must however, be borne in mind that the value of the mineral or oil and gas asset of an exploration company is important for the users of the financial reports of such a company. Table 6.9 also indicates that all the respondents agreed that a disclosure objective should enable the users of the financial reports of a company to determine whether the mineral or oil and gas asset was contributing to the performance of that company.

The extractive industry is high risk, capital intensive and influenced by commodity price fluctuations (Otto, 2000:3). Exploration activities usually take place over a long period of time (Cartwright, 1991). It is important for both the investors and the users of the financial reports to evaluate the risks involved in the mineral or oil and gas asset of the entity concerned. Table 6.9 illustrates that 81,8% of the respondents agreed that one of the disclosure objectives should enable users of the financial reports of an entity to evaluate the nature and extent of risks and uncertainties associated with the mineral or oil and gas asset of that entity, while 18,2% strongly agreed. There are various risks and uncertainties involved in mineral exploration and this disclosure objective would ensure that the users of the financial reports of exploration companies would be informed of these risks and uncertainties to enable them to determine the value of the mineral or oil and gas asset.

Question 12: *Types of information that should be disclosed relating to reserve quantities (Table 5.1 in DP).*

A proved mineral reserve refers to the highest level of confidence obtainable while a probable reserve is estimated with a lower level of confidence than a proved mineral reserve (SAMCODE, 2007).

Table 6.10: Question 12

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>Proved and probable reserve quantities.</i>	1	9,1	0	0,0	3	27,3	7	63,6	11
<i>Estimation methods used in determining reserve quantities.</i>	1	9,1	0	0,0	3	27,3	7	63,6	11
<i>Main assumptions used in determining reserve quantities.</i>	1	9,1	2	18,2	1	9,1	7	63,6	11
<i>Sensitivity analysis in respect of main assumptions used to determine reserve quantities.</i>	1	9,1	0	0,0	5	45,5	5	45,4	11
<i>Reconciliation of changes in the estimated reserves quantities from year to year.</i>	1	9,1	0	0,0	3	27,3	7	63,6	11
<i>The level of reserve quantity disclosure is by commodity and is broken down by country or project.</i>	0	0,0	0	0,0	6	54,5	5	45,5	11

Table 6.10 illustrates that 63,6% of the respondents strongly agreed with the recommendation of the DP that both proved and probable mineral reserve quantities should be disclosed, 27,3% agreed while 9,1% strongly disagreed. Reserves represent economically mineable material (SAMCODE, 2008) and, thus, constitute extremely important information for the users of the financial statements of entities in the extractive industry as this information provides a reliable indication of future economic benefits that may flow to the entity.

The data which an exploration company obtains from surveys, boreholes, trenches, pits and other prospecting work will enable that company to classify the mineral reserve concerned as either probable or proved. Various estimates are used in the determination of reserves (IASB, 2010b:124) and the disclosure of these estimates constitutes vital information for the users of financial reports. Table 6.10 illustrates that 63,6% of the respondents strongly agreed with the recommendation of the DP that estimation methods used in the determination of reserve quantities should be disclosed, 27,3% agree, while 9,1% strongly disagreed. Estimates are subjective and may change on a daily basis or from person to person. This disclosure would ensure that the users of the financial reports were aware of the estimates that had been used in determining the reserves.

Various assumptions are used in the determination of reserves (IASB, 2010b:124) and disclosure of these main assumptions is crucial for the users of financial reports. Table 6.10 indicates that 63,6% of the respondents strongly agreed with the recommendation of the DP that the main assumptions used in the determination of reserve quantities should be disclosed, 9,1% agreed, 18,2% disagreed and 9,1% strongly disagreed.

A sensitivity analysis disclosure can be useful in helping to explain the uncertainties associated with the reserves quantity estimate made as at the reporting date (IASB, 2010b:128). The sensitivity analysis disclosure should be provided to reflect the sensitivity of the reserves quantity estimate to changes in the main economic assumptions. Sensitivity analysis would reveal the change in the reserve quantities, if different assumptions had been used by the entity concerned (IASB, 2010b:128). Table 6.10 shows that 91% (45,5% + 45,5%) of the respondents agreed with the disclosure of a sensitivity analysis. Such a disclosure would provide important information to the users of the financial reports although it would increase the disclosure burden of junior exploration companies (IASB, 2010b:129). A sensitivity analysis of this type could require input from qualified geologists, other geoscientists and engineers. Junior exploration companies may have to conduct such an analysis as an in-house study or use consultants if the necessary expertise from qualified geologists, other geoscientists and engineers are not available in-house.

Table 6.10 also illustrates that 63,6% of the respondents strongly agreed with the recommendation of the DP that a reconciliation of reserve quantities from year to year should be disclosed, 27,3% agreed while 9,1% strongly disagreed. Such a reconciliation would indicate

whether the exploration work performed during the year by junior exploration companies had improved the existing knowledge of possible reserves or not (IASB, 2010b:131). Table 6.10 also shows that 45,5% of respondents strongly agreed while 54,5% agreed that the reserve quantities should be disclosed per commodity and broken down either by country or by project. Such a disclosure on the part of junior exploration companies would indicate to the users of the financial reports the projects or the countries with the most potential to develop to a mine.

Question 13: *The following current value measurements information, that corresponds to reserve quantities disclosed, should be disclosed if asset is measured at historical cost (Table 5.1 in DP).*

Table 6.11: Question 13

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>Range of fair value estimates.</i>	1	9,1	0	0,0	10	90,9	0	0,0	11
<i>Disclose the preparation basis of the fair value estimates.</i>	0	0,0	0	0,0	9	81,8	2	18,2	11
<i>Disclose the main assumptions used in determining the fair value estimates.</i>	0	0,0	0	0,0	9	81,8	2	18,2	11
<i>A reconciliation of changes in the current value measurement from year to year.</i>	1	9,1	0	0,0	8	72,7	2	18,2	11

Table 6.11 reflects that 90,9% of respondents agreed with the disclosure of fair value estimates while 9,1% strongly disagreed. This provides an indication that the respondents are prepared to conduct these valuations either in-house or involve external consultants.

All respondents agreed with the recommendation of the DP that, if the fair value estimates were

disclosed, the basis of preparation of these fair values should be disclosed. This would ensure that the users of the financial reports were aware which method had been used to determine the fair value as well as by whom the values had been prepared.

Various assumptions may be used in the determination of fair values and the DP recommends the main assumptions used in determining of fair value estimates should be disclosed. All the respondents agreed with the recommendation of the DP that the main assumptions used to determine the fair values should be disclosed.

Table 6.11 shows that 90,9% (72,7% + 18,2%) of the respondents agreed with the recommendation of the DP that a reconciliation of the changes in the current value measurement of reserve quantities should be disclosed while 9,1% of the respondents strongly disagreed. The measurement of the current values of reserve quantities is subject to variables (IASB, 2010b:134) such as commodity prices, interest rates and exchange rates. This reconciliation would provide an indication of the reasons for any fluctuations in the current values from year to year.

Question 14: *Other types of information that should be disclosed.*

Table 6.12: Question 14

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>Disclosure of production revenues by commodity.</i>	0	0,0	0	0,0	5	45,5	6	54,5	11
<i>Separate disclosure of the exploration, development and production costs for the current period and as a time series over a defined period (such as five years).</i>	0	0,0	0	0,0	10	90,9	1	9,1	11

Table 6.12 illustrates that all the respondents agreed with the recommendation of the DP that disclosure of production revenue by commodity should be disclosed. This information is applicable to producing mines as junior exploration companies would not have mineral sales. This information could indicate to the users of the financial reports which of the commodities had contributed the most to the performance of the company.

Table 6.12 also indicates that all the respondents agreed with the recommendation of the DP that disclosure of exploration, development and production costs for the current period and over a defined period should be disclosed. This information would enable the users of the financial reports to compare the costs involved in exploring and extracting the minerals over a period of time. In addition, this information would also enable them to compare the costs incurred in extracting the minerals to the revenue earned by the commodities (IASB, 2010b:143).

6.3.2.7. Publish what you pay (PWYP) disclosure

Question 15: Publish what you pay (PWYP) disclosure.

Both the IASB and the Revenue Watch Institute sponsored a discussion on the Publish What You Pay (PWYP) campaign (IASB, 2010a:145). This campaign encourages companies to disclose the amounts they pay to resource-rich developing countries. The aim of the campaign is to hold these governments accountable for the management of revenue they receive from mineral, oil and gas industries (IASB, 2010a:145). The majority of the respondents agreed with the proposal of the DP to disclose the amounts paid to governments.

Table 6.13: Question 15

Rating scale	Strongly Disagree		Disagree		Agree		Strongly Agree		Total
	No:	%	No:	%	No:	%	No:	%	
<i>Disclose the payments (royalties, taxes, dividends, bonuses, license and concession fees) made by an entity to governments on a country-by-country basis.</i>	0	0,0	1	9,0	5	45,5	5	45,5	11

The lack of transparency in many African countries has meant that very little of their natural mineral wealth has either been shared or transferred to the people of the African countries (Games, 2010). Table 6.13 illustrates that 45,5% of the respondents strongly agreed, while 45,5% agreed, that disclosure of the payments made to governments on a country-by-country basis may ensure that these governments were held accountable for the management of the revenue from minerals.

Question 16: *Are there any comments you would like to include with reference to the abovementioned recommendations by the project team of the discussion paper on extractive activities?*

No additional comments were received from the respondents.

6.3.3. IFRS 6, Exploration for and evaluation of mineral resources section

This section of the questionnaire aimed, to establish the accounting policies and treatment of pre-exploration and exploration and evaluation costs on the part of junior exploration companies to determine whether the accounting practices of junior exploration companies are consistently applied.

Question 17: *Has the company started with its exploration activities?*

This question aimed to establish whether the respondents had incurred exploration costs other than the costs in respect of the prospecting right application.

Table 6.14: Question 17

Dichotomous choice	Frequency	%
Yes	11	100,0
No	0	0,0
Total	11	100,0

It emerged that all of the respondents had started with their exploration activities.

Question 18: *Who is performing or going to perform the company's exploration activities?*

The responses to this question were aimed at providing background information on the exploration companies that had participated in the survey. It was hoped that this information would enhance the researcher's understanding of the responses of the respondents.

Table 6.15: Question 18

Multiple-choice	Frequency	%
The company itself	4	36,4
External contractors	6	54,5
Joint Venture	0	0,0
Other	1	9,1
Total	11	100,0

Table 6.15 indicates that 54,5% of the respondents had used external contractors, 36,4% of the respondents were doing the exploration work themselves while 9,1% indicated that the company was carrying out the exploration work itself as well as making use of external contractors.

6.3.3.1. Pre-exploration related expenditure

As indicated in IFRS 6 paragraph 5 (IASB, 2010a) IFRS 6 applies to the exploration and evaluation expenditure incurred once the entity has obtained a legal right to explore a specific area. This implies that companies would need to possess some form of legal right over exploration before applicable costs can be capitalised (Williamson, 2005b: 64). The treatment of pre-exploration expenses may be obtained from the Framework (IASB, 2010a) definitions of assets and expenses, and by applying the principles of asset recognition as contained in both IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a). The aim of question 19 was to determine whether accounting practices in the treatment of pre-exploration expenditure by junior exploration companies are consistently applied.

Question 19: *How does the company treat the following pre-exploration related expenditure?*

Table 6.16: Question 19

Multiple-choice	Asset		Expense		Not applicable		Total
	No:	%	No:	%	No:	%	
Acquisition of third party studies over regions of land	10	90,9	1	9,1	0	0,0	11
Acquisition of studies to determine the exploration history of an area	10	90,9	1	9,1	0	0,0	11
Preparatory work to prepare exploration teams	2	18,2	9	81,8	0	0,0	11
Developing of geological hypotheses	7	63,6	4	36,4	0	0,0	11
Application for prospecting rights	0	0,0	11	100	0	0,0	11
Equipment and infrastructure	10	90,9	0	0,0	1	9,1	11
General overhead costs directly attributable to pre-exploration activities	0	0,0	11	0,0	0	0,0	11

It is incumbent on the respondents to treat pre-exploration expenses in accordance with the Framework (IASB, 2010a) and by applying the principles of asset recognition as contained in both IAS16 (IASB, 2010a) and IAS 38 (IASB, 2010a). As per paragraph 49(a) of the Framework (IASB, 2010a) an asset may be defined as a resource which is controlled by an entity as a result of past events and from which future economic benefits are expected to flow of the entity. Table 6.16 indicates that 90,9% of the respondents treated the acquisition of third-party studies over regions of land and acquisition of studies to determine the exploration history of an area as an asset. Accordingly, the acquisition of studies may be recognised as an asset only if it is probable that future benefits will flow to the entity as a result of that asset. Generally, pre-exploration expenditure cannot be associated with any specific reserves as they generally are speculative in nature (KPMG, 2005). Although it may be possible to measure the cost of this expenditure reliably the probability of future economic benefits may not be sufficiently certain at the stage at which the expenditure was incurred and, thus, it is highly likely that acquisition of studies be recognised as an expense.

Table 6.16 also indicates that 81,8% of the respondents treated expenditure relating to the preparation of exploration teams as an expense while 18,2% treated this expenditure as an asset. It is highly unlikely that expenditure associated with the preparation of the exploration team be recognised as an asset as the probability of future economic benefits may not be sufficiently certain at the stage at which the expenditure was incurred.

While, 63,6% of the respondents treated pre-exploration expenditure relating to the development of a geological hypotheses as an asset, while 36,4% of the respondents treated this expenditure as an expense in the financial reports of the companies concerned. These costs might qualify for recognition as an intangible asset in accordance with IAS 38 (IASB, 2010a), to the extent that the costs might give rise to proprietary information that the entity has the ability to control (KPMG, 2005), but future economic benefits may not be sufficiently certain at the stage at which the expenditure was incurred.

Table 6.16 indicates that all the respondents treated the expenditure incurred in respect of the application of a prospecting right as an expense. The cost of a separately acquired intangible asset will, according to paragraph 27(a) of IAS 38 (IASB, 2010a), comprise its purchase price, including import duties and non-refundable purchase taxes, as well as certain directly attributable costs. Expenditure directly attributable to the application of a prospecting right could also be recognised as part of an intangible asset, for example prospecting rights, in accordance with IAS 38 (IASB, 2010a).

It may happen that junior exploration companies incur expenditure in acquiring equipment before actually obtaining a prospecting right. This type of expenditure should be treated according to the principles of asset recognition as contained in IAS 16 (IASB, 2010a).

Table 6.16 also indicates that all the respondents treated general overhead costs directly attributable to pre-exploration expenditure as an expense. This treatment is correct as per the Framework (IASB, 2010a).

The responses to question 19 all confirmed the findings of the literature review in chapter 3 of this study. The literature review had highlighted the lack in uniformity and acceptable accounting practices in the extractive industries. Question 19 clearly indicates that accounting practices in the treatment of pre-exploration expenditure by junior exploration companies are not consistently

applied. Question 19 also highlights the fact that the respondents were not using the Framework (IASB, 2010a) definitions of assets and expenses and the principles of asset recognition as contained in both IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a) to determine the accounting treatment of pre-exploration expenditure.

6.3.3.2. Accounting policy for exploration and evaluation expenditure

Question 20: Which one of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?

IFRS 6 (IASB, 2010a) requires that an entity shall determine an accounting policy which stipulates the expenditure that will form part of the exploration and evaluation assets of the entity. In determining an accounting policy for exploration and evaluation expenditure the main issue is to determine either whether to capitalise these costs or to record them as expenses in the period in which they were incurred. In section 3.7.1 of this study alternative methods of accounting for exploration and evaluation expenditure were discussed. The aim of question 20 was to determine whether accounting practices in the treatment of pre-exploration expenditure by junior exploration companies are consistently applied.

Table 6.17: Question 20

Multiple-choice	Frequency	%
Full expense method	2	18,2
Full cost method	7	63,6
Successful efforts methods	0	0,0
Area of interest method	0	0,0
Expense and reinstate method	0	0,0
Area of interest with provision method	2	18,2
Total	11	100.0

Table 6.17 indicates that 63,6% of the respondents used the full cost method to account for their exploration and evaluation expenditure. This method capitalise all costs. The full expense method was implemented by 18,2% of the respondents while another 18,2% used the area of interest with provision method. The area of interest with provision method capitalises all costs associated with an area and, simultaneously, creates an equal amount provision. The provision is reversed should it be found that the area is economically viable. Question 20 confirms the

findings of the literature review in chapter 3 of this study. It had emerged from the literature review that junior exploration companies in their accounting for their exploration and evaluation expenditure use various alternative accounting methods. This highlights the lack in uniformity in the accounting practices implemented by junior exploration companies and indicates that accounting practices in the treatment of exploration expenditure by junior exploration companies are not consistently applied.

Question 21: *Does the company's accounting policy determine which expenditure is recognised as exploration and evaluation assets (IFRS 6 par. 9)?*

This question was applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs. The remaining two respondents used the full expense method that expenses all exploration and evaluation costs. Of the nine respondents with accounting policies that aimed at capitalising exploration and evaluation costs, 100% of them did indeed; comply with the requirements contained in paragraph 9 of IFRS 6 (IASB, 2010a).

Question 22: *Are the following expenditures included in the initial measurement of the exploration and evaluation assets of the company (IFRS 6, par. 9):*

- *Acquisition of rights to explore;*
- *Topographical, geological, geochemical or geophysical studies;*
- *Exploratory drilling;*
- *Trenching;*
- *Sampling;*
- *Technical feasibility studies;*
- *Exploration staff related costs; and*
- *Administration and general overhead costs directly attributable to exploration and evaluation activities.*

Paragraph 6 of IFRS 6 (IASB, 2010a) includes a non-exhaustive list of examples of expenditure that may be included in the initial measurement of the exploration and evaluation assets of a company. The basis for conclusions in IFRS 6 paragraph BC28 (IASB, 2010a) stipulate that the treatment of administration and general overhead costs directly attributable to exploration and evaluation activities would be an accounting policy choice. The aim of question 22 was to determine the type of expenditure which junior exploration companies include in their exploration

and evaluation assets. All of the respondents with accounting policies in place that aimed at capitalising exploration and evaluation costs agreed that all of the abovementioned expenditure had been included in their initial measurement of their exploration and evaluation assets.

Question 23: *Does the company recognise any obligation for the removal and restoration (rehabilitation) as a consequence of having undertaken the exploration and evaluation of mineral resources (IFRS 6. par. 11)?*

Paragraph 11 of IFRS 6 (IASB, 2010a) specifies that an entity should recognise any obligation in accordance with IAS 37 (IASB, 2010a).

Table 6.18: Question 23

Dichotomous choice	Frequency	%
Yes	10	90,9
No	0	0,0
Not applicable	1	9,1
Total	11	100,0

Table 6.18 indicates that 90,9% of the respondents had created an obligation for rehabilitation as a consequence of the exploration work undertaken.

6.3.3.3. Classification of exploration and evaluation assets

Question 24: *Does the company classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired (IFRS 6, par.15)?*

Paragraph 15 of IFRS 6 (IASB, 2010a) requires that entities classify exploration and evaluation assets as either tangible or intangible, according to the nature of the assets and this classification be applied consistently. This question is applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs. The remaining two respondents used the full expense method that expenses all exploration and evaluation costs and therefore has no exploration and evaluation assets.

All of the respondents (9 respondents) with accounting policies in place that are aimed at capitalising exploration and evaluation costs, classify their assets as either tangible or intangible.

Question 25: *How does the company classify the following exploration and evaluation assets?*

- *Acquisition of rights to explore;*
- *Topographical, geological, geochemical or geophysical studies;*
- *Exploratory drilling;*
- *Trenching;*
- *Sampling;*
- *Technical feasibility studies;*
- *Exploration staff related costs;*
- *Administration and general overhead costs directly attributable to exploration and evaluation activities; and*
- *Equipment and infrastructure.*

The aim of question 25 was to determine the classification of exploration and evaluation assets on the part of junior exploration companies. However, this question is not applicable to those respondents who implement the full expense method as these respondents would not have exploration and evaluation assets. Those respondents who implemented either the full cost method or the area of interest with provision method classified all of the abovementioned expenditure as intangible except for equipment and infrastructure, which was classified as tangible.

6.3.3.4. Measurement of exploration and evaluation assets

Question 26: *What subsequent measurement model does the company apply to exploration and evaluation assets (IFRS 6, par. 12)?*

According to paragraph 12 of IFRS 6 (IASB, 2010a) an entity shall, after recognition, apply either the cost model or the revaluation model to the exploration and evaluation assets. This question is not applicable to the two respondents who implement the full expense method as these respondents would not have exploration and evaluation assets. This question was applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs.

Table 6.19: Question 26

Dichotomous choice	Frequency	%
Cost model	4	44,4
Revaluation model	5	56,6
Total	9	100,0

Table 6.19 indicates that 56,6% of the nine respondents used the revaluation model, while 44,4% implemented the cost model. The respondents that use the revaluation model represent the five companies that form part of the same group

Question 27: *Does the company use the prospecting right period to determine the useful life of the intangible exploration and evaluation assets (IAS 38, par. 88)?*

As determined in questions 24 and 25 the respondents classified the exploration and evaluation assets according to their nature as either tangible or intangible. Paragraph 89 of IAS 38 (IASB, 2010a) determines that the accounting for an intangible asset is based on the useful life of that intangible asset. The aim of question 27 was to establish the way in which junior exploration companies determine the useful life of their intangible exploration and evaluation assets as prospecting rights may not exceed five years and may be renewed once for a period not exceeding three years (Coertse, 2005:18). This question was applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs.

Table 6.20: Question 27

Dichotomous choice	Frequency	%
Yes	7	77,8
No	2	22,2
Total	9	100,0

Table 6.20 indicates that 77,8% of the nine respondents with accounting policies that aimed at capitalising exploration and evaluation costs, determined the useful life of their intangible exploration and evaluation assets as the prospecting right period. While 22,2% of the nine respondents with accounting policies that aimed at capitalising exploration and evaluation costs, instead determined that, if a mine were established, the intangible assets were either amortised accordingly or when the prospecting rights had expired or, when the project was no longer

considered viable for any further prospecting, the intangible assets were impaired. According to IAS 38 (IASB, 2010a) an intangible asset shall be carried at cost or revalued amount less accumulated amortisation and impairment and, hence, the treatment of the 22,2% of the respondents is not in accordance with to the requirements of IAS 38 (IASB, 2010a).

Question 28: *Which one of the following methods would best describe the method the company uses to determine the fair value of intangible exploration and evaluation assets?*

- *Market approach – uses prices and other relevant information generated in market transactions involving identical or comparable assets;*
- *Cash flow approach – calculates fair value by discounting estimated future cash flows;*
- *Cost approach – the current replacement cost or*
- *Other.*

This question is applicable only to the five respondents (refer Table 6.19) who used the revaluation model as the subsequent measurement of their exploration and evaluation assets. The five respondents who used the revaluation model as the subsequent measurement of their exploration and evaluation assets determined the fair value by using the cash flow approach. According to SAMVAL (SAMCODE, 2008) the three generally accepted approaches to mineral asset valuation are the cash flow approach, market approach and cost approach.

Question 29: *Does the company use external consultants to determine the fair value of the company's intangible exploration and evaluation assets?*

This question is applicable only to the five respondents (refer Table 6.19) who used the revaluation model as the subsequent measurement of their exploration and evaluation assets. The aim of this question was to determine whether the fair value calculations were done in-house. The five respondents who used the revaluation model for the subsequent measurement of their exploration and evaluation assets used external contractors to calculate the fair values of the exploration and evaluation assets.

Question 30: *Please state how often the company revalues its exploration and evaluation assets?*

This was an open ended question and was applicable only to five respondents (refer Table 6.19) who used the revaluation model as the subsequent measurement of their exploration and evaluation assets. The five companies that formed part of the same group used the revaluation

model and these five companies all indicated that they revalued their exploration and evaluation assets on an annual basis.

6.3.3.5. Impairment of exploration and evaluation assets

Question 31: *Does the company test its exploration and evaluation assets for impairment?*

Paragraph 18 of IFRS 6 (IASB, 2010a) stipulates that exploration and evaluation assets shall be assessed for impairment when facts and circumstances suggest impairment. This question was applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs. All of the respondents with exploration and evaluation assets tested their exploration and evaluation assets for impairment.

Question 32: *Does the company have an accounting policy for allocating exploration and evaluation assets to cash-generating units (CGU) for the purpose of assessing such assets for impairment (IFRS 6, par. 21)?*

IFRS 6 (IASB, 2010a) requires an entity to specify the level at which exploration and evaluation assets are assessed for impairment while an entity shall determine its own accounting policy in respect of the allocation of exploration and evaluation assets to CGU. This question was applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs. All the respondents with exploration and evaluation assets did have an accounting policy in place for allocating their exploration and evaluation assets to CGU.

Question 33: *Does the company use external consultants to determine the recoverable amount of the exploration and evaluation assets or CGU (IAS 36, par. 18)?*

Paragraph 18 of IFRS 6 (IASB, 2010a) stipulates that, if the carrying amount of an exploration and evaluation asset exceeds its recoverable amount, then an impairment loss shall be recognised. The aim of this question was to determine whether the respondents determined the recoverable amount in-house. This question was applicable only to the nine (refer to Table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs.

Table 6.21: Question 33

Dichotomous choice	Frequency	%
Yes	7	77,8
No	2	22,2
Total	9	100,0

Table 6.21 indicates that of the nine respondents, 77,8% used external contractors to calculate the recoverable amount while 22,2% of the nine respondents calculated the recoverable amount in-house.

Question 34: *When does the company test for impairment?*

The aim of this question was to determine the frequency of the impairment testing as IFRS 6 (IASB, 2010a) requires impairment testing only when facts and circumstances suggest impairment. This question was applicable only to the nine (refer to table 6.17) respondents with accounting policies that aimed at capitalising exploration and evaluation costs.

All of the respondents with exploration and evaluation assets tested these assets for impairment at each reporting period and not according to IFRS 6 (IASB, 2010a) which stipulates that it is necessary to test for impairment only when facts and circumstances suggest impairment.

6.3.3.6. Disclosure

Question 35: *Does the company disclose its accounting policy in respect of both its exploration and evaluation expenditure as well as its recognition of its exploration and evaluation assets (IFRS 6, par. 24)?*

According to paragraph 24 of IFRS 6 (IASB, 2010a) an entity should disclose its policy regarding its treatment of both exploration and evaluation expenditure and assets.

Table 6.22: Question 35

Dichotomous choice	Frequency	%
Yes	10	90,9
No	1	9,1
Total	11	100,0

Table 6.22 reflects that 90,9% of respondents did disclose their accounting policies in respect of

their treatment of both their exploration and evaluation expenditure and assets while 9,1% did not disclose their accounting policies. However, it is incumbent on all junior exploration companies to disclose their accounting policies in respect of their treatment of their exploration or evaluation costs.

Question 36: *Does the company disclose the amounts that arise from the exploration for and evaluation of mineral resources in the following elements of the financial statements?*

- *Assets;*
- *Liabilities;*
- *Income;*
- *Expenses;*
- *Operating cash flows; and*
- *Investing cash flows.*

Paragraph 24 of IFRS 6 (IASB, 2010a) requires the disclosure of those amounts that arise as a result of the exploration for and evaluation of mineral resources in each element of the financial statements of an entity. All the respondents confirmed that they did disclose the amounts that arose as a result of exploration for and evaluation of mineral resources in each of the abovementioned elements of their financial statements, except for the income section. The table below illustrates the responses received regarding the disclosure of these amounts in income.

Table 6.23: Question 36

Dichotomous choice	Frequency	%
Yes	9	81,8
No	0	0,0
Not applicable	2	18,2
Total	11	100,0

Table 6.23 illustrates that 18,2% of the respondents indicated that they did not disclose the amounts relating to the exploration for and evaluation of mineral resources in the income section as this was not applicable to them. The assumption was that these respondents probably did not have any income to disclose at this stage.

Question 37: *Does the company disclose information in its financial statements relating to its resources and/or reserves?*

The most significant assets of junior exploration companies are their mineral reserves and resources. However, IFRS 6 (IASB, 2010a) does not require disclosure of mineral reserves or resources. The aim of this question was to determine whether the respondents did, indeed, disclose information to the users of their financial reports regarding their most significant assets.

Table 6.24: Question 37

Dichotomous choice	Frequency	%
Yes	7	63,6
No	4	36,4
Total	11	100,0

Table 6.24 illustrates that 63,6% of the respondents did disclose information regarding their resources and/or reserves in their financial reports, while 36,4% of the respondents did not disclose information relating to their resources and/or reserves. The DP (IASB, 2010b) on extractive industries recommends extensive disclosure of reserves. However, the majority of the respondents were already disclosing information relating to their resources and/or reserves.

Question 38: *Does the company use the South African Mineral Resource Committee (SAMREC) Code for guidance on the reporting of its resources and/or reserves?*

This question was applicable only to the seven respondents (refer to Table 6.24) who did disclose information relating to their resources and/or reserves. All of the seven respondents that disclosed information relating to their resources and/or reserves utilised the SAMREC (SAMCODE, 2007) Code. This will ensure that disclosure relating to resources and/or reserves will be consistent between entities and on an annual basis.

6.3.4. Application of the Income Tax Act no 58 of 1962 to junior exploration companies section

This section of the questionnaire aimed to investigate the tax consequences of exploration and evaluation costs for junior exploration companies not yet involved in mining activities to establish whether taxation practices of junior exploration companies are consistently applied.

Question 39: *What is/was the dominant intention of the exploration company in obtaining prospecting rights?*

In determining the nature of either a receipt or an accrual for tax purposes the intention of the taxpayer should be established. The aim of this question was, indeed, to establish the intention of the respondents.

Table 6.25: Question 39

Multiple-choice	Frequency	%
Speculative purposes	2	18,2
Establish a mine	9	81,8
Enter into royalty agreement	0	0,0
Total	11	100,0

Table 6.25 indicates that 81,8% of the respondents had obtained prospecting rights with the intention to establish a mine while 18,2% had obtained prospecting rights because of a speculative intention. If prospecting is conducted in the hope of locating remunerative mineral deposits with the objective of selling the rights at a profit then the exploration expenditure incurred will be of a revenue nature (refer to discussion in section 4.3.2. of this study). On the other hand, when prospecting is conducted in order to establish a mine then the exploration expenditure incurred by a junior exploration company is of a capital nature (refer to discussion in section 4.3.2. of this study).

Question 40: *Does the company have mining rights?*

The aim of this question was to establish whether the respondents had obtained mining rights after the date on which the lists used in the study had been received from the DMR. This would provide background information on the responses received regarding the taxation treatment of exploration related costs.

Table 6.26: Question 40

Dichotomous choice	Frequency	%
Yes	8	72,7
No	3	27,3
Total	11	100,0

Table 6.26 indicates that 72,7% of the respondents did have mining rights while 27,3% of the respondents had prospecting rights only. 72,7% of the respondents' prospecting work was successful and with mining rights might have earned mining income.

6.3.4.1. Prospecting and exploration expenditure

Question 41: *In terms of the Income Tax Act how does the company classify the nature of its prospecting/exploration expenditure?*

It is important to determine the nature of prospecting expenditure as expenditure of a revenue nature may qualify for deduction in terms of the general deduction formula while expenditure of a capital nature may only be deducted if a special deduction provision exists (Van Blerck, 1992:9-4). The exploration and evaluation costs incurred by an exploration company may be of a capital and revenue nature. However, the nature of exploration expenditure depends on the intention of the junior exploration company. This question aimed to establish the way in which the respondents classified the nature of their exploration expenditure.

Table 6.27: Question 41

Dichotomous choice	Frequency	%
Revenue nature	6	54,5
Capital nature	5	45,5
Total	11	100,0

Table 6.27 illustrates that 54,5% of the respondents classified their exploration expenditure as being of a revenue nature while 45,5% of respondents classified their exploration expenditure as being of a capital nature. As discussed in section 4.3.2 of this study, when a junior exploration company conducts prospecting in order to establish a mine, then the exploration expenditure incurred is of a capital nature. The majority of the respondents classified their exploration expenditure as being of a revenue nature despite the fact that Table 6.25 had shown that only 18,2% of the respondents had classified their dominant intention as speculative.

Question 42: *Which section in the Income Tax Act does the company utilise for its prospecting/exploration expenditure?*

The Income Tax Act contains various sections that may be used for the deduction of exploration expenditure from taxable income or mining income. Prospecting by a speculator with the objective to sell the rights constitutes a trade and, as the expenditure concerned would be in the

production of income and for the purpose of the trade, the exploration expenditure would be deducted in terms of the general deduction formula contained in section 11(a) of the Income Tax Act (refer to discussion in section 4.3.3. of this study). Special deduction provisions exist in sections 15(a) and 15(b) of the Income Tax Act that allow deductions from the income derived from mining operations (refer to discussion in section 4.3.4. of this study). Should an exploration company that is prospecting with the aim of establishing a mine sell its prospecting rights then the base cost will be calculated according to paragraph 20(1)(a) of the Eighth Schedule to the Income Tax Act (refer to discussion in section 4.3.4. of this study).

Table 6.28: Question 42

Multiple choice	Frequency	%
Section 11(a)	4	36,3
Section 15(a) and Section 36	5	45,5
Section 15(b)	2	18,2
Paragraph 20(1)(a) of the Eighth Schedule	0	0,0
Other	0	0,0
Total	11	100,0

Table 6.28 illustrates that 36,3% of the respondents used the general deduction formula contained in section 11(a) of the Income Tax Act to claim exploration expenditure for taxation purposes while 63,7% (45,5% + 18,2%) of the respondents used section 15 of the Income Tax Act to claim exploration expenditure for taxation purposes. The Income Tax Act stipulates in section 11(a) that a taxpayer is allowed to deduct from income derived from carrying on a trade, expenditure and losses actually incurred in the production of income, provided that such expenditure is not of a capital nature. Table 6.25 illustrates that it was the intention of 81,8% of the respondents to establish a mine. As discussed in section 4.3.2 of this study, when a junior exploration company carries out prospecting in order to establish a mine, the exploration expenditure thus incurred is of a capital nature. Table 6.28 illustrates that respondents used the general deduction formula even if their exploration expenditure is of a capital nature.

The responses to question 42 (refer to Table 6.28) were matched to the respective respondents responses to question 39 (refer to Table 6.25).

The 18,2% respondents (refer Table 6.28) that indicated their intention was speculative in Table 6.25 used the special deduction provision in section 15(b) of the Income Tax Act even though the nature of the prospecting expenditure was of a revenue nature.

Thirty six point three (36,3%) percent of the respondents (refer Table 6.28) used the general deduction formula to obtain a deduction for their prospecting expenditure incurred while they indicated earlier in Table 6.25 their dominant intention was to establish a mine; therefore the prospecting expenditure incurred by the junior exploration companies was of a capital nature. Section 11(a) of the Income Tax Act may not be used when the expenditure is of a capital nature.

45,5% of the respondents (refer to Table 6.28) used section 15(a) and section 36 of the Income Tax Act to obtain a deduction for their prospecting expenditure incurred. Section 15(a) read together with section 36 of the Income Tax Act allows a special deduction provision in respect of certain capital expenditure (i.e. shaft sinking, mine equipment, infrastructure etc.) to be deducted from the income derived from mining operations. These respondents indicated earlier in Table 6.25 their dominant intention was to establish a mine therefore the prospecting expenditure incurred by the junior exploration companies was of a capital nature. Although section 15(a) read together with section 36 of the Income Tax Act is a special deduction provision for capital expenditure incurred by taxpayers who derive income from mining operations, section 15(b) of the Income Tax Act specifically addresses prospecting expenditure while section 15(a) read together with section 36 does not.

Question 43: *Did the company consider the prospecting/exploration expenditure incurred as trading stock?*

The possibility also exists that the prospecting/exploration expenditure incurred at any stage be considered as trading stock, subject to being brought into taxable income under section 22(1) of the Income Tax Act (KPMG, 1993:11). The effect of section 22 is that the deduction of the expenditure is postponed until the year of sale and, thus, the deduction is matched with the income. Exploration companies with a speculative intention may consider applying this section of the Income Tax Act.

Table 6.29: Question 43

Dichotomous choice	Frequency	%
Yes	0	0,0
No	11	100,0
Total	11	100,0

Table 6.29 indicates that 100% of the respondents did not consider their prospecting/exploration expenditure as trading stock and therefore used either section 11(a) or section 15 of the Income Tax Act to obtain a deduction for their prospecting/exploration expenditure.

6.3.4.2. Mining income

Question 44: *How does the company classify its royalty income from prospecting rights in terms of the Income Tax Act?*

This question was applicable to those companies that had indicated that their dominant intention in obtaining prospecting rights had been to obtain royalty income from the rights. As not one of the respondents had indicated that their main intention was to enter into royalty agreements, this question was not applicable to 100% of the respondents.

Question 45: *Does the company earn any mining income as defined by the Income Tax Act?*

The deductions allowed in terms of section 15 of the Income Tax Act are against mining income only. The purpose of this question was to determine whether any of the companies earned mining income.

Table 6.30: Question 45

Dichotomous choice	Frequency	%
Yes	1	9,1
No	10	90,9
Total	11	100,0

Table 6.30 reflects that only 9,1% of the respondents earned mining income despite the fact that Table 6.26 had indicated that 72,7% of the respondents were in possession of mining rights. In addition, Table 6.28 had shown that 63,7% (45,5% + 18,2%) of the respondents utilised section 15 of the Income Tax Act to claim exploration expenditure for taxation purposes although the deductions allowed according to section 15 of the Income Tax Act are against mining income

only. Table 6.30 indicates that 90,9% of the respondents did not earn any mining income and, thus, for the majority of the respondents the deductions allowed according to section 15 of the Income Tax Act should have been carried forward as unredeemed capital expenditure.

Question 46: *Does the company earn any non-mining income?*

The purpose of this question was to determine whether the respondents earned other income that was not related to their exploration activities.

Table 6.31: Question 46

Dichotomous choice	Frequency	%
Yes	1	9,1
No	10	90,9
Total	11	100,0

Table 6.30 and 6.31 both illustrate that 90,9% of the respondents did not earn any income and that all funding received from shareholders was used in their exploration activities.

Question 47: *According to the company's tax assessment did the South African Revenue Services (SARS) limit the deduction allowed in terms of section 15(b) to the mining income of the company?*

The Income Tax Act does not address exploration expenditure of a capital nature incurred by junior exploration companies; the aim of this question was to determine the treatment of exploration expenditure SARS. Section 15(b) of the Income Tax Act deals specifically with expenditure incurred by the taxpayer on prospecting operations and the deductions allowed in terms of section 15 of the Income Tax Act are against mining income only. The aim of this question was to establish whether the SARS limits the deduction to mining income as specified by the Income Tax Act. This question was applicable only to those respondents who had selected section 15(b) in question 42 and did have any mining income. None of the respondents that utilised section 15(b) of the Income Tax Act had mining income. The respondents which earned mining income (refer to Table 6.30) utilised section 11(a) of the Income Tax Act (refer to Table 6.28). Therefore, the researcher was not able to determine whether SARS limits the deduction according to section 15(b) to mining income only.

Question 48: *According to the company's tax assessment, did the South African Revenue Services (SARS) allow the deduction in terms of section 15(b) against the non-mining income of the company?*

The Income Tax Act does not address exploration expenditure of a capital nature incurred by junior exploration companies, the aim of this question was to determine the treatment of exploration expenditure by SARS. This question was applicable only to those respondents who had selected section 15(b) of the Income Tax Act in question 42 and did have non-mining income, but no mining income. Section 15(b) of the Income Tax Act only allows the deduction of exploration expenditure of a capital nature against mining income. None of the respondents who utilised section 15(b) of the Income Tax Act had non-mining income. Therefore, the researcher was not able to determine whether SARS allowed the deduction in terms of section 15(b) of the Income Tax Act against non-mining income.

Question 49: *According to the company's tax assessment, did the South African Revenue Services (SARS) allow the deduction in terms of section 15(b) to be carried forward as either an assessed loss or as unredeemed capital expenditure?*

The Income Tax Act does not address exploration expenditure of a capital nature incurred by junior exploration companies; the aim of this question was to determine the treatment of exploration expenditure by SARS. This question determine whether, should a junior exploration company not have any income, the deductions allowed in terms of section 15(b) of the Income Tax Act would create an assessed loss. The question was applicable only to those respondents who had selected section 15(b) in question 42 and did not have any mining and non-mining income. Two of the respondents (refer Table 6.28) utilised section 15(b) of the Income Tax Act and were allowed to create an assessed loss with the special deduction provision stipulated in section 15(b). When an assessed loss is created that assessed loss could be used against non-mining income. However, this is a contradiction of the requirements set out in section 15(b) of the Income Tax Act as deductions allowed in terms of section 15(b) of the Income Tax Act are against mining income only.

The responses to question 49 were matched to the respective respondents responses to question 39 (refer to Table 6.25). It should be noted that the respondents that used the special deduction provision in section 15(b) of the Income Tax Act also indicated their intention is speculative in Table 6.25. It is possible that the SARS allowed an assessed loss to be created by section 15(b) because the nature of the expenditure of the two respondents was of a revenue

nature. The two respondents used the wrong section of the Income Tax Act instead of section 11(a) of the Income Tax Act.

6.3.4.3. Disposal of prospecting rights

Question 50: *Has the company disposed of any of its prospecting rights?*

As discussed in section 4.3.4.3 of this study, section 37 of the Income Tax Act deals with the calculation of capital expenditure on the sale of mining property. Prospective activities alone do not constitute mining and do not meet the definition of the term “mining property”. This question was included to determine with a follow-up question (refer to question 50) which section of the Income Tax Act had been utilised to account for the sale of the prospecting rights.

Table 6.32: Question 50

Dichotomous choice	Frequency	%
Yes	2	18,2
No	9	81,8
Total	11	100,0

Table 6.32 reflects that 18,2% of the respondents had sold their prospecting rights while 81,8% of the respondents had not sold any of their prospecting rights. The MPRDA stipulates that prospecting rights may not be sold without the consent of the Minister although this is a time consuming exercise.

Question 51: *Did the company apply section 37 of the Income Tax Act?*

Section 37 of the Income Tax Act deals with the calculation of capital expenditure on the sale, transfer, lease or cession of mining property. In *Murchison Exploration and Mining Co Ltd v Commissioner for Inland Revenue (supra)* Maritz J came to the conclusion that, in the case of a company that is involved entirely in prospecting and exploration activities, the activities of such a company do not constitute “mining operations”. Accordingly, prospecting activities do not constitute mining and, as such, do not fulfil the definition of mining property. As a result, section 37 does not apply when a junior exploration company sells its prospecting rights. The aim of this question was to determine whether the junior exploration companies used section 37 of the Income Tax Act if they sold their prospecting right. This question was applicable only to those respondents who had sold their prospecting rights. Two of the respondents (refer Table 6.32) had sold prospecting rights and had correctly not used section 37 of the Income Tax Act.

Question 52: *With the disposal of the prospecting right, did the company apply the Eighth Schedule to the Income Tax Act?*

The Eighth Schedule to the Income Tax Act deals with the regulations of capital gains tax. The aim of this question was to determine whether the junior exploration companies used The Eighth Schedule to the Income Tax Act if they sold their prospecting right. This question was applicable only to those respondents who had sold their prospecting rights. Two of the respondents (refer to Table 6.32) had sold prospecting rights and had not used the Eighth Schedule to the Income Tax Act. The responses to question 52 were matched to the respective respondents responses to question 39 (refer to Table 6.25). The two respondents who had sold prospecting rights had, in question 39, indicated that their intention with their prospecting rights had been speculative. Those respondents who had sold their prospecting rights for speculative reasons would not pay capital gains tax although the entire proceeds of the sale would be included in their taxable income. The two respondents who had sold prospecting rights had correctly not used the Eighth Schedule to the Income Tax Act.

6.3.4.4. Other tax matters

Questions relating to other tax matters relating to junior exploration companies were included as they could influence taxation practices of junior exploration companies.

Question 53: *Does the company utilise section 37A of the Income Tax Act?*

Section 37A of the Income Tax Act allows deductions from income of any cash paid during the year of assessment to a closure rehabilitation company or trust. According to the MPRDA exploration companies are obliged to make financial provision for the rehabilitation of any environmental impact. As discussed in section 4.3.5.1 of this study the DMR stopped junior exploration companies from using insurance firms to underwrite their rehabilitation obligations in favour of more expensive cash or bank guarantees (Seccombe, 2009). It appears as if the DMR favours cash or bank guarantees from junior exploration companies for their rehabilitation obligation, this could lead to junior exploration companies not using section 37A of the Income Tax Act.

Table 6.33: Question 53

Dichotomous choice	Frequency	%
Yes	0	0,0
No	11	100,0
Total	11	100,0

Table 6.33 illustrates that none of the respondents had made use of section 37A of the Income Tax Act. The responses to question 53 were matched to the respective respondents responses to question 23 (refer to Table 6.18). Table 6.18 had indicated that 90,9% of the respondents did recognise an obligation for rehabilitation as a consequence of having undertaken exploration activities. Nevertheless, Table 6.33 illustrates that no cash was being paid to either closure rehabilitation companies or trusts.

Question 54: *Is the company registered with the Commissioner in accordance with section 2 of the Mineral and Petroleum Resources Royalty (Administration) Act?*

The aim of the question was to establish whether the junior exploration companies were complying with the regulation contained in section 2 of the Mineral and Petroleum Resources Royalty Administration Act 29 of 2008 (MPRRAA). This section stipulates that all companies with prospecting or explorations rights had to register with the Commissioner before 30 June 2009. Junior exploration companies need to register even if the companies are not producing; a lot of junior exploration companies are not aware of this fact (Prinsloo, 2009).

Table 6.34: Question 54

Dichotomous choice	Frequency	%
Yes	6	54,5
No	5	45,5
Total	11	100,0

Table 6.34 illustrates that 54,5% of the respondents were in compliance with section 2 of the MPRRAA while 45,5% of the respondents were not complying with the Act.

Question 55: *Other tax matters*

The aim of the below questions was to establish whether the respondents were aware of the requirements of the Mineral and Petroleum Resources Royalty Act 28 of 2008 (MPRRA) and

section 12J of the Income Tax Act as it could influence junior exploration companies taxation practices.

Table 6.35: Question 55

Multiple-choice	Yes		No		I don't know		Total
	No:	%	No:	%	No:	%	
<i>Will the company have to pay any royalties in 2010/2011 in terms of the Mineral and Petroleum Resources Royalty Act?</i>	0	0,0	8	72,7	3	27,3	11
<i>Is a venture capital company (VCC), as defined by section 12J of the Income Tax Act, a shareholder of the company?</i>	0	0,0	6	54,5	5	45,5	11
<i>Does the company qualify as an investment for a VCC in accordance with section 12J of the Income Tax Act?</i>	0	0,0	5	45,5	6	54,5	11
<i>Do you think section 12J of the Income Tax Act will improve local financing of junior exploration companies?</i>	0	0,0	0	0,0	11	100	11

The purpose of the MPRRA is to enforce the payment of royalties in respect of the extraction of the country's minerals. Although junior exploration companies are not involved in large-scale mining they do extract minerals for the purposes of analysis and sampling. Table 6.35 indicates that 72,7% of the respondents will not have to pay any royalties on the extraction of minerals in their sampling efforts. The mining royalty regime came into effect in 2010 but Table 6.35 illustrates that 27,3% of the respondents were unsure whether they would be liable for any royalty payments. This shows that not all the role players in the mineral industry are familiar with the regulations of the new royalties bill.

The intention of section 12J of the Income Tax Act is to provide a tax incentive for investors in both small and medium sized enterprises and in junior mining exploration companies in South Africa (Camay, 2008). This section may assist junior exploration companies to obtain additional investment. Table 6.35 illustrates that 54,5% of the respondents do not have a VCC as a shareholder while 45,5% of the respondents were unsure whether a VCC is, indeed, a shareholder in their companies. While, 45,5% of the respondents did not qualify as an investment opportunity for VCC in terms of section 12J of the Income Tax Act while 54,5% of the respondents were unsure whether their company does qualify as an investment opportunity for a VCC. The majority of the respondents appeared to be unaware of the requirements of section 12J of the Income Tax Act. All of the respondents were unsure whether section 12J of the Income Tax Act would, indeed, improve local financing of junior exploration companies.

6.4 SUMMARY AND CONCLUSION

A questionnaire consisting of four sections namely, biographical section, new IFRS developments (DP on extractive activities) section, IFRS 6, (Exploration for and evaluation of mineral resources) section and finally the application of the Income Tax Act to junior exploration companies section, was distributed to junior exploration companies with company registration numbers after the year 2003 and with more than five prospecting rights each.

The purpose of the biographical section of the questionnaire was to obtain information on the respondents of the questionnaire in order to provide background information of the companies represented by the respondents of the questionnaire.

The aim of the new IFRS developments (DP on extractive activities) section was to obtain feedback from junior exploration companies on the recommendations made by the DP (IASB, 2010b) as these recommendations could influence future accounting practices of junior exploration companies. The majority of the respondents agreed with all of the proposed recommendations contained in the DP on extractive activities (IASB, 2010b).

The aim of the IFRS 6, (Exploration for and evaluation of mineral resources) section was to establish the accounting policies and treatment of exploration and evaluation costs according to IFRS 6 (IASB, 2010a) on the part of junior exploration companies to determine whether the accounting practices of junior exploration companies are consistently applied. The significant findings in respect of this section of the questionnaire are firstly, the respondents did not treat

pre-exploration expenses consistently in accordance with the definitions of assets and expenses in the Framework (IASB, 2010a) or the principles of asset recognition as contained in both, IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a). Secondly, junior exploration companies use various alternative policies in their accounting for exploration and evaluation expenditure. This section of the questionnaire highlighted the lack in uniformity and acceptable accounting practices by junior exploration companies and confirmed that junior exploration companies do not apply accounting practices consistently.

The aim of the application of the Income Tax Act to junior exploration companies section was to investigate the tax consequences of exploration and evaluation costs for junior exploration companies not yet involved in mining activities to establish whether taxation practices of junior exploration companies are consistently applied. The significant findings relating to this section of the questionnaire on the application of the Income Tax Act to junior exploration companies included, firstly, the classification of the nature of exploration expenditure as either capital or revenue by the respondents did not reflect their intention of either speculative or to establish a mine correctly. Secondly, respondents used the general deduction formula even if their exploration expenditure was of a capital nature and thirdly respondents used the special deduction provision of section 15 of the Income Tax Act even though their exploration expenditure was of a revenue nature. This section of the questionnaire highlighted that junior exploration companies do not apply taxation practices consistently.

The above research results confirmed many of the conclusions and problems which had been highlighted in chapters 1 to 4 of this study. Overall, research results support the findings of this study that junior exploration companies implement various accounting and taxation practices and that these practices lack uniformity. The following chapter contains the conclusions and recommendations of the study.

CHAPTER 7

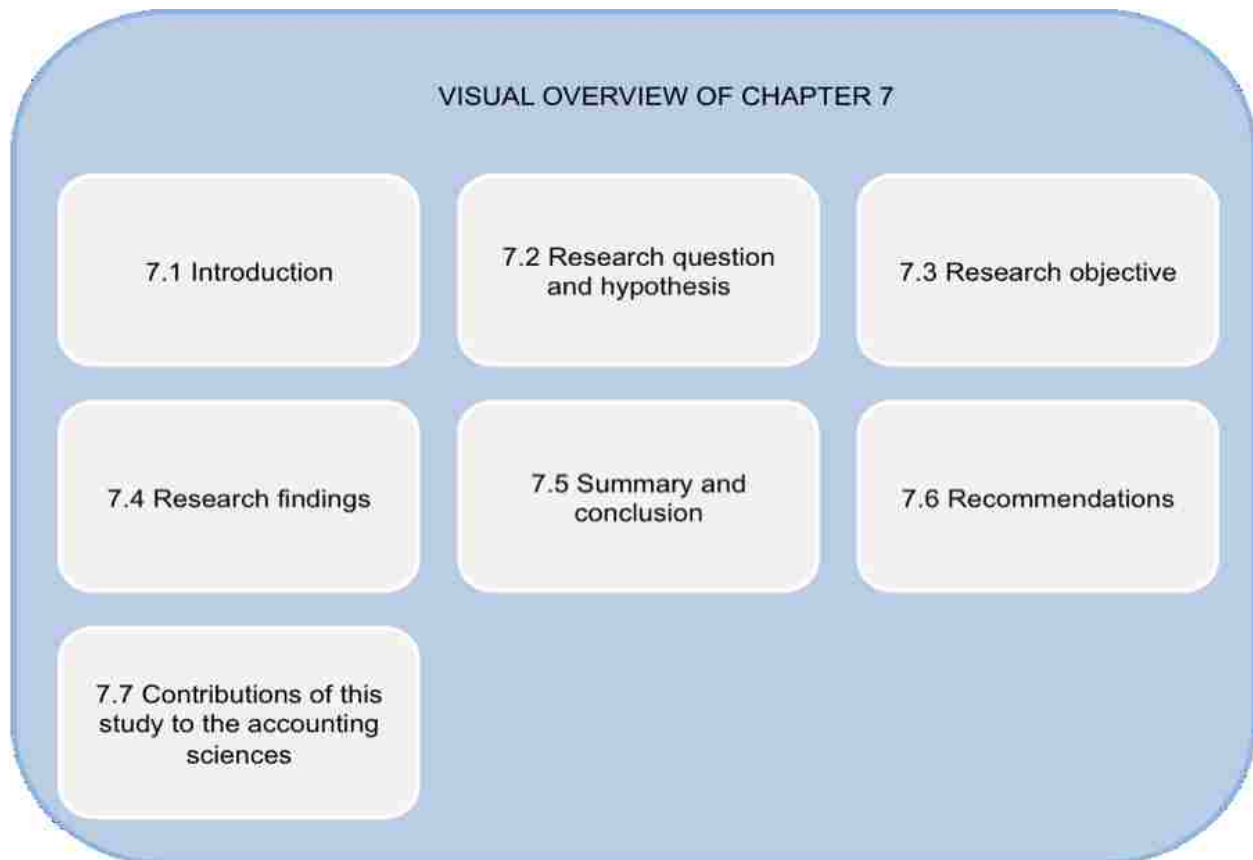
CONCLUSIONS AND RECOMMENDATIONS

7.1 INTRODUCTION

With the promulgation of the Mineral and Petroleum Resources Development Act 28 of 2002 (MPRDA) in 2004, the concept of state custodianship of mineral rights replaced the common law principles of privately owned mineral rights (Keaton Energy, 2008). State custodianship of mineral rights allows the state to exercise sovereignty of the nation's mineral wealth and confirms the mineral policy view of the African National Congress (ANC) as contained in its Freedom Charter of 1955 (ANC, 1955). The MPRDA has allowed a significant number of junior exploration companies to become active in the extractive industry of South Africa (Keaton Energy, 2008). Junior exploration companies are exclusively involved in basic prospecting and exploration activities (Van Blerck, 1992:9–3). The lack of both standardised and comparable accounting practices in the extractive industries has long been recognised, as has the lack of provisions in the Income Tax Act 58 of 1962 (Income Tax Act) dealing with junior exploration companies involved exclusively in prospecting and exploration activities. The purpose of this study was to investigate whether accounting and taxation practices of junior exploration companies are consistently applied.

The purpose of this chapter is to report on the research objective, as highlighted in chapter 1, to provide a summary of the research findings discussed in the previous chapters, and to draw conclusions and make recommendations.

The layout of this chapter is as follows:



7.2 RESEARCH QUESTION AND HYPOTHESIS

There are various phases of mining, but junior exploration companies are only involved in the pre-exploration and exploration phase. The pre-exploration phase refers to all expenditure incurred before an entity has obtained the legal right to explore a specific area, while the exploration phase begins as soon as the entity has obtained a prospecting right and ends upon completion of a feasibility study (KPMG, 2009). During the pre-exploration phase, junior exploration companies can obtain the appropriate accounting treatment of pre-exploration expenditure from the Framework's definitions of assets and expenses, and the principles of asset recognition as contained in IAS 16, *Property, plant and equipment*, and IAS 38, *Intangible assets* (KPMG, 2005). Junior exploration companies could interpret the definitions of assets and expenses in the Framework (IASB, 2010a) differently and this could lead to a diversity of accounting practices for the treatment of pre-exploration expenditure. IFRS 6 is applicable only to exploration and evaluation expenditure incurred by junior exploration companies after the entity has obtained a legal right to explore a given area (Cengage Learning, 2011). Junior exploration companies will therefore apply IFRS 6 (IASB, 2010a), *Exploration for and evaluation of mineral resources*, during the exploration phase. IFRS 6 (IASB, 2010a) allows junior

exploration companies to develop accounting policies for the recognition of exploration and evaluation assets without considering the Framework (IASB, 2010a) and other IFRSs. Given the requirements of IFRS 6 (IASB, 2010a), a diversity of accounting practices for the treatment of exploration and evaluation expenditure exists.

Junior exploration companies are exclusively involved in basic prospecting and exploration activities (Van Blerck, 1992:9–3). Neither the terms “prospecting” nor “exploration” are defined in the Income Tax Act, but “mining” and “mining operations” are defined in section 1 of the Income Tax Act. However, in the context of a company that is involved exclusively in basic prospecting and exploration, such a company’s prospecting and exploration activities do not constitute “mining operations” as defined in the Income Tax Act (Van Blerck, 1992:9–3). The special deduction provision in section 15(b) of the Income Tax Act deals with expenditure incurred on prospecting operations, but is only allowed against income derived from mining operations. Therefore, junior exploration companies will not be able to use the special deduction provision, as their exploration activities do not constitute “mining operations” as defined in the Act. In addition, the Income Tax Act does not address exploration expenditure of a capital nature incurred by junior exploration companies, which could lead to various interpretations and taxation practices by junior exploration companies that are not consistently applied.

The study focused on the research question of this study. Are the accounting and taxation practices applied by junior exploration companies in South Africa consistent?

The hypothesis of the study is that junior exploration companies in South Africa do not consistently apply accounting and taxation practices.

7.3 RESEARCH OBJECTIVE

The objective of this study was to perform a literature review and to carry out empirical research by using questionnaires that were distributed to junior exploration companies to investigate whether accounting and taxation practices are consistently applied.

7.4 RESEARCH FINDINGS

The research findings of the literature review and the empirical results are discussed below.

7.4.1. Accounting practices

During the pre-exploration phase, junior exploration companies can obtain the appropriate accounting treatment of pre-exploration expenses from the Framework definitions of assets and expenses, and by applying the principles of asset recognition as contained in IAS 16 and IAS 38 (KPMG, 2005). The Framework (IASB, 2010a) defines an asset as a resource which is controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity in question. Although in the case of junior exploration companies it may be possible to measure the cost of pre-exploration expenditure reliably, the probability of future economic benefits may not be sufficiently certain at the stage at which the pre-exploration expenditure was incurred and, thus, it is highly likely that pre-exploration expenditure may be recognised as an expense. When items of plant and equipment are used during the pre-exploration phase the principles of asset recognition as contained in IAS 16 (IASB, 2010a) should be considered. The principles of asset recognition as contained in IAS 16 (IASB, 2010a) will allow any items of plant and equipment used during the pre-exploration phase to be capitalised within property, plant and equipment and depreciated over their useful lives (PWC, 2007). Typical pre-exploration expenditure where the principles of asset recognition as contained in IAS 38 (IASB, 2010a) could be considered are acquisition of speculative seismic data and expenditure on the subsequent geological and geophysical analysis of this data. These costs might qualify for recognition as an intangible asset to the extent that pre-exploration costs give rise to proprietary information that the entity has the ability to control (KPMG, 2005). A number of other pre-exploration expenditures may include pre-acquisition expenditure relating to the acquisition of an intangible asset, for example expenditure directly attributable to the acquisition or application of a prospecting right. This expenditure will be recognised as part of an intangible asset, for example prospecting rights, in accordance with IAS 38 (IASB, 2010a). Because expenditure incurred by junior exploration companies during the pre-exploration phase are scoped out of most relevant standards, including IFRS 6 (IASB, 2010a), the definitions of assets and expenses from the Framework (IASB, 2010a) and the principles of asset recognition contained in IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a) should be considered in the accounting treatment of pre-exploration expenditure. The interpretation of the definitions of assets and expenses and the principles of asset recognition could be different for each junior exploration company; this leads to a diversity of accounting practices for the treatment of pre-

exploration expenditure. The findings in response to question 19 (see chapter 6) revealed that the accounting treatment of pre-exploration expenditure by the respondents varied. The findings in response to question 19 (see chapter 6) also revealed that a number of the respondents did not apply the definition of an asset according to the Framework (IASB, 2010a) correctly and did not consider the principles of asset recognition according to IAS 38 (IASB, 2010a) correctly. The findings confirmed that accounting practices in the treatment of pre-exploration expenditure by junior exploration companies are not consistently applied.

During the exploration phase, IFRS 6 (IASB, 2010a) is applicable to exploration and evaluation expenditure incurred by junior exploration companies. Under IFRS 6 (IASB, 2010a), a junior exploration company has to determine an accounting policy specifying which expenditures on exploration and evaluation activities will be recorded as exploration and evaluation assets and then apply that policy consistently (PWC, 2007). IFRS 6 (IASB, 2010a) allows entities temporary exemption from paragraphs 11 and 12 of IAS 8 (IASB, 2010a) and this exemption allows junior exploration companies to develop an accounting policy which may not totally comply with the Framework (IASB, 2010a). In deciding on an accounting policy for exploration and evaluation expenditure the main issue is to determine whether to capitalise these costs or to record them as expenses in the period in which they were incurred. The full cost method and the successful efforts method are the two most popular methods in accounting for exploration and evaluation expenditure (Epstein & Jermakowicz, 2009), with the full cost method being common among junior exploration companies (PWC, 2007). The area of interest method is another major approach to capitalisation of exploration and evaluation expenditure and it is believed to be fairly commonly used in the mining industry (Epstein & Jermakowicz, 2009). The research findings which emerged from the responses of the respondents to question 20 (see chapter 6) revealed that the respondents' accounting policies in respect of exploration and evaluation costs included either the full expense method (18,2% of respondents), full cost method (63,6% of respondents), or area of interest with provision method (18,2% of respondents). The full cost method was the most used method by the respondents to question 20 (chapter 6); this agreed with the literature review findings. The findings in response to question 20 (chapter 6) confirmed the finding that the significant flexibility allowed by IFRS 6 (IASB, 2010a) leads to a diversity of accounting practices for the treatment of exploration and evaluation expenditure by junior exploration companies. IFRS 6 (IASB, 2010a) requires an entity to determine an accounting policy that stipulates which expenditure will form part of the exploration and evaluation assets of the entity. The findings in chapter 6 indicated that all of the respondents did, indeed, have in place an

accounting policy (question 20) which stipulated which expenditure formed part of their exploration and evaluation assets (question 21). Paragraph 6 of IFRS 6 (IASB, 2010a) includes a non-exhaustive list of examples of expenditure that may be included in the initial measurement of exploration and evaluation assets and all of the respondents included the examples on this list as expenditure that formed part of their exploration and evaluation assets (question 22). The basis for conclusions in IFRS 6 paragraph BC28 (IASB, 2010a) stipulates that the treatment of administrative and general overhead costs directly attributable to exploration and evaluation activities would comprise an accounting policy choice. All of the respondents in chapter 6 (question 22) with accounting policies in terms of which exploration and evaluation costs were capitalised included administrative and general overhead costs directly attributable to exploration and evaluation activities in the initial measurement of their exploration and evaluation assets. Although there is a diversity of accounting practices for the treatment of exploration and evaluation expenditure by junior exploration companies, all of the respondents to the questionnaire with accounting policies in terms of which exploration and evaluation costs were capitalised, included the same type of exploration expenditure, including administrative and general overhead costs, in the initial measurement of exploration and evaluation assets.

IFRS 6 (IASB, 2010a) requires exploration and evaluation assets to be classified as either tangible or intangible assets according to the nature of the assets acquired. Current industry practice as to the classification of exploration and evaluation assets varies (KPMG, 2005). The findings which emerged from the responses to question 24 (see chapter 6) indicated that those respondents with accounting policies in terms of which exploration and evaluation costs were capitalised do, indeed, classify their exploration and evaluation assets according to their nature. The findings of question 25 (chapter 6) indicated that the respondents classified the exploration expenditure as intangible except for equipment and infrastructure, which was classified as tangible.

An entity should choose either the cost or the revaluation model as subsequent measurement of exploration and evaluation assets according to IFRS 6 (IASB, 2010a). In practice, the revaluation of intangible exploration and evaluation assets is very rare as these assets are rarely homogenous (KPMG, 2005). The findings in response to question 26 (see chapter 6) revealed that the respondents to the questionnaire with accounting policies in terms of which exploration and evaluation costs were capitalised, used both the cost and revaluation model as subsequent measurement model. The respondents that used the revaluation model used the cash flow

approach to determine the fair value of the exploration and evaluation assets according to the findings of question 28 (chapter 6) and the findings of question 29 (chapter 6), which revealed that the respondents that used the revaluation model used external consultants to determine the fair value. According to the findings of question 25 (chapter) the respondents that applied the revaluation model classified exploration expenditure as intangible assets. The revaluation model in IAS 38 (IASB, 2010a) may be used only if it is possible to establish the asset's fair value by reference to an active market. It is very rare for an intangible exploration and evaluation asset to meet the conditions of the definition of an active market.

IFRS 6 (IASB, 2010a) requires a mining entity to assess exploration and evaluation assets for impairment only when facts and circumstances suggest that the carrying amount of an asset may exceed its recoverable amount; this allows junior exploration companies not to test exploration and evaluation assets on an annual basis. The findings in response to question 31 (see chapter 6) confirmed that all the respondents with exploration and evaluation assets tested the exploration and evaluation assets for impairment. The findings in response to question 34 (see chapter 6) revealed that all the respondents tested their exploration and evaluation assets for impairment at each reporting period and not when facts and circumstances suggest impairment. Therefore, the frequency at which the respondents tested for impairment is non-compliant with the requirements of IFRS 6 (IASB, 2010a). IFRS 6 (IASB, 2010a) also requires an entity to specify the level at which exploration and evaluation assets are assessed for impairment. Accordingly, an entity shall determine an accounting policy for allocating exploration and evaluation assets to CGU. The findings in chapter 6 (question 32) indicated that all of the respondents with accounting policies in terms of which exploration and evaluation costs were capitalised had, indeed, put in place a policy for allocating their exploration and evaluation assets to CGU.

Resources and reserves are at the heart of a junior exploration company's value. IFRS 6 (IASB, 2010a) does not require any disclosure regarding mineral resources or reserves, but the findings in response to question 37 (see chapter 6) indicated that the majority (63,6%) of the respondents did disclose information regarding their resources and reserves. Recommendations of the DP on extractive activities (IASB, 2010b) include significant disclosure information of mineral reserves.

A DP on extractive activities (IASB, 2010b) was issued by the International Accounting Standards Board (IASB) in April 2010 and will eventually supersede IFRS 6 (IASB, 2010a). The recommendations of the DP (IASB, 2010b) will influence future accounting practices of junior exploration companies. Significant recommendations of the DP (IASB, 2010b) were: the scope of this encompasses the financial reporting issue relating to the exploration for and the finding of minerals and oil and natural gas deposits; the developing of these deposits and the extracting of the minerals and oil and natural gas; that legal rights, such as prospecting or mining rights, form the basis of the mineral or oil and gas assets; these assets be measured at historical cost; and significant disclosure about the mineral or oil and gas assets (including mineral reserves) is required. The study also revealed in question 6 (chapter 6) to question 15 (chapter 6) that the majority of the respondents agreed with all of the recommendations of the DP on extractive activities (IASB, 2010b).

The findings of this study confirmed that junior exploration companies in South Africa do not consistently apply accounting practices.

7.4.2. Taxation practices

It is important to determine the nature of exploration expenditure, as expenditure of a revenue nature may qualify for deduction in terms of the general deduction formula, while expenditure of a capital nature may only be deducted if a special deduction provision exists (Van Blerck, 1992:9–4). The exploration and evaluation costs incurred by junior exploration companies may be of a capital and revenue nature. The nature of exploration expenditure depends on the intention of junior exploration companies. The intention of junior exploration companies is either to conduct the business of prospecting for speculative purposes or to establish a mine. If prospecting is conducted in the hope of locating remunerative mineral deposits with the objective of selling the rights at a profit, then the exploration expenditure incurred is of a revenue nature (Van Blerck, 1992:9–5). However, if prospecting is conducted in order to establish a mine, the exploration expenditure incurred by the junior exploration company is of a capital nature (Van Blerck, 1992:9–4). The research findings in question 39 (chapter 6) indicated that 81,8% of the respondents had obtained their prospecting rights with the intention of establishing a mine, while 18,2% had obtained their prospecting rights with a speculative intention. While the research findings in question 41 (chapter 6) revealed that 54,5% of the respondents classified their exploration expenditure as being of a revenue nature, while 45,5% of respondents classified their exploration expenditure as being of a capital nature – this despite

the fact that 81,8% of the respondents' exploration expenditure were of a capital nature. The golden rule in determining the nature of expenditure incurred for taxation purposes is to establish the intention of the taxpayer; the findings in chapter 6 (questions 39 and 41) clearly indicated that the respondents to the questionnaire of this study did not classify the nature of exploration expenditure according to the dominant intention of the junior exploration company concerned.

Expenditure of a capital nature may only be deducted if a special deduction provision exists. Section 15(b) of the Income Tax Act provides for a special deduction from income derived from mining operations of any prospecting expenditure incurred during the year of assessment. However, in the context of a company that is involved exclusively in basic prospecting and exploration, such a company's prospecting and exploration activities do not constitute "mining operations" as defined in the Income Tax Act (Van Blerck, 1992:9–3). Therefore, a junior exploration company with the intention of establishing a mine may only use the special deduction in section 15(b) of the Income Tax Act as soon as the company has generated mining income. A junior exploration company with the intention of establishing a mine does not qualify for deductions in terms of the general deduction formula because their exploration expenditure is of a capital nature. Because the Income Tax Act does not specifically address exploration expenditure of a capital nature incurred by junior exploration companies, various taxation practices are applied by junior exploration companies. Firstly, all exploration expenditure is carried forward to the year of commencement of production and deducted when mining income is derived (Platmin Limited, 2010). Secondly, exploration expenditure is carried forward in terms of the assessed loss provision (Van Blerck, 1992:9–6) or thirdly junior exploration companies use the general deduction formula incorrectly. However, The Marais Committee confirmed that exploration companies prospecting to establish a mine would be allowed to use the special deduction provision of section 15(b) of the Income Tax Act once they had earned mining income. The research findings in question 42 (chapter 6) indicated that the respondents did not use the correct sections in the Income Tax Act for the nature (capital or revenue) of their exploration expenditure. The research findings in question 42 (chapter 6) revealed that 36,3% of the respondents wrongly used the general deduction formula in section 11(a) of the Income Tax Act. The abovementioned 36,3% of the respondents indicated that their dominant intention was to establish a mine and therefore the prospecting expenditure incurred by the junior exploration companies was of a capital nature. The findings in question 42 (chapter 6) also revealed that 18,2% respondents that indicated their intention was speculative, incorrectly used the special

deduction provision in section 15(b) of the Income Tax Act even though the nature of the prospecting expenditure was of a revenue nature. Question 42 (chapter 6) further revealed that 45,5% of the respondents used the special deduction provision of section 15(a) read together with section 36 of the Income Tax Act. Although section 15(b) of the Income Tax Act specifically addresses prospecting expenditure and not section 15(a) read together with section 36, both section 15(a) and section 15(b) of the Income Tax Act allow deductions from income derived from mining operations. Junior exploration companies with a speculative intention may consider applying section 22 (trading stock) of the Income Tax Act. The research findings in question 43 (chapter 6) indicated that none of the respondents considered exploration expenditure as trading stock.

The research findings in question 45 revealed that 9,1% of respondents earned mining income. The abovementioned 9,1% respondents indicated that their intention was to establish a mine; therefore the exploration expenditure was of a capital nature. The findings in question 42 (chapter 6) indicated that the abovementioned 9,1% respondents wrongly used the general deduction formula in section 11(a) of the Income Tax Act for exploration expenditure and should have used the special deduction provision in section 15(b) of the Income Tax Act. The special deduction provision in section 15(b) of the Income Tax Act allows for a deduction from income derived from mining operations; it is therefore limited to mining income earned. Because the abovementioned 9,1% of respondents incorrectly used the general deduction formula in section 11(a) of the Income Tax Act, it could have been possible to create an assessed loss if the exploration expenditure was more than the mining income. If the special deduction provision in section 15(b) of the Income Tax Act was correctly used, the abovementioned 9,1% respondents could not create an assessed loss if the exploration expenditure was more than the mining income.

The research findings in chapter 6 (question 42) revealed that 18,2% of respondents used section 15(b) of the Income Tax Act to claim exploration expenditure. Section 15(b) of the Income Tax Act allows deductions of exploration expenditure from income derived from mining operations. Should the taxpayer not have any income from mining operations then the unclaimed exploration expenditure of the current year may be carried forward to the following year as an unredeemed capital balance. The 18,2% of respondents (question 39, chapter 6) who indicated that their intention with their prospecting rights had been of a speculative nature were the same respondents (question 42, chapter 6) who had indicated that they utilised section

15(b) of the Income Tax Act to claim exploration expenditure. These same respondents also indicated (question 49) that they had been allowed, according to their tax assessment from SARS, to create an assessed loss with their claim for exploration expenditure in terms of section 15(b) of the Income Tax Act. This finding revealed that, even though the exploration expenditure was of a revenue nature, the junior exploration companies that participated in this study were, nevertheless, allowed to utilise section 15(b) for their exploration expenditure in their tax assessment from SARS. The junior exploration companies were also allowed to create an assessed loss in their tax assessment from SARS even though section 15(b) clearly states that this special deduction provision is available to be offset against mining income only. It could also have been possible that SARS realised they had used the wrong section of the Income Tax Act and would have been allowed to create an assessed loss if section 11(a) of the Income Tax Act were correctly used by the abovementioned respondents.

Other specific tax matters relating to junior exploration companies that could influence their taxation practices include section 37A of the Income Tax Act and the Mineral and Petroleum Resources Royalty Administration Act 29 of 2008 (MPRRAA). Section 37A of the Income Tax Act allows a deduction from income of any cash paid during the year of assessment to a closure rehabilitation company or trust, but it appears as if the DMR favours cash or bank guarantees from junior exploration companies for their rehabilitation obligation; this could lead to taxation practices by junior exploration companies not using section 37A of the Income Tax Act. The study showed in question 23 (chapter 6) that 90,9% of the respondents recognised an obligation in respect of rehabilitation in their accounting records, but question 53 (chapter 6) revealed that none of the respondents used section 37A of the Income Tax Act, which allows deductions from income of any cash paid during the year of assessment to either a closure rehabilitation company or trust. This confirmed the literature study finding that because the DMR favours cash or bank guarantees from junior exploration companies for their rehabilitation obligation, this leads to junior exploration companies not using section 37A of the Income Tax Act.

According to the MPRRAA, junior exploration companies need to register even if the companies are not producing; many junior exploration companies are not aware of this fact (Prinsloo, 2009). Question 54 (chapter 6) indicated that 45,5% of the respondents have not registered with the Commissioner in terms of the MPRRAA. This confirmed the literature review finding that not all of the junior exploration companies are aware that they have to register in terms of section 2 of the MPRRAA.

The findings of this study confirmed that junior exploration companies in South Africa do not consistently apply taxation practices.

7.5 SUMMARY AND CONCLUSION

The promulgation of the MPRDA in 2004 allowed for a significant increase in the number of junior exploration companies in South Africa. Junior exploration companies are exclusively involved in basic prospecting and exploration activities, and their activities can be divided into the pre-exploration and exploration phases. The accounting treatment of expenditure incurred by junior exploration companies during the pre-exploration phase can be obtained from the Framework's (IASB, 2010a) definitions of assets and expenses, and the principles of asset recognition as contained in IAS 16 (IASB, 2010a) and IAS 38 (IASB, 2010a). Interpretation by junior exploration companies of the assets and expenses and the principles of asset recognition varies and leads to a diversity of accounting practices for the treatment of pre-exploration expenditure. IFRS 6 (IASB, 2010a) is applicable to exploration and evaluation expenditure incurred by junior exploration companies during the exploration phase. Under IFRS 6 (IASB, 2010a), a junior exploration company has to determine an accounting policy specifying which expenditures on exploration and evaluation activities will be recorded as exploration and evaluation assets. The accounting policy determined by the junior exploration company may not totally comply with the Framework (IASB, 2010a), however. The significant flexibility allowed by IFRS 6 (IASB, 2010a) leads to a diversity of accounting practices for the treatment of exploration and evaluation expenditure by junior exploration companies. The study focused on the issue of whether accounting practices are consistently applied by junior exploration companies in South Africa. The findings confirmed that accounting practices in the treatment of pre-exploration and exploration expenditure by junior exploration companies are not consistently applied.

Mining tax reform relating to special deduction provisions in the Income Tax Act was last carried out in the early 1990s, at which time the large mining houses were carrying out most of the exploration work. Large mining houses were able to use the special deduction provision in section 15 of the Income Tax Act as they derived income from their mining operations. The terms "mining" and "mining operations" are both defined in section 1 of the Income Tax Act, but neither "prospecting" nor "exploration" is defined. The Income Tax Act does not address exploration expenditure of a capital nature incurred by junior exploration companies, this leads to various interpretations and taxation practices by junior exploration companies that are not consistently applied. The study focused on the issue of whether taxation practices are

consistently applied by junior exploration companies in South Africa. The findings confirmed that taxation practices by junior exploration companies are not consistently applied.

7.6 RECOMMENDATIONS

This research has shown that various accounting practices are in use by junior exploration companies. The IASB issued a DP on extractive activities in April 2010 (IASB, 2010b), and, in addition, plans to make a decision in 2011 on whether the extractive activities project should be added to its agenda (IFRS Foundation, 2010). It is, however, imperative that the IASB realise the urgency of a standardised and comparable standard in the extractive industries to ensure that junior exploration companies consistently apply accounting practices. Even if the extractive activities project were added to the agenda in 2011, it would still be a number of years before an IFRS would be issued to address the financial reporting of the extractive industry, including that of junior exploration companies.

Mining tax reform relating to special deduction provisions in the Income Tax Act was last carried out in the early 1990 at which time the large mining houses were carrying out most of the exploration work. These large mining houses earned mining income that enabled them to utilise the special deduction provisions relating to exploration expenses. The promulgation of the MPRDA in 2004 led to a significant increase in the number of junior exploration companies solely involved in exploration activities and which do not earn mining income. However, the Income Tax Act does not cater for companies that are involved solely in exploration work with the aim of establishing a mine. The study also revealed that the taxation practices of junior exploration companies and SARS do not comply with regulations contained in the Income Tax Act. It is, thus, recommended that junior exploration companies receive clear guidance from SARS on their practices relating to the tax treatment of exploration expenditure of a capital nature. It is also further recommended that the Income Tax Act be reviewed to ensure compliance with the SARS practice in respect of the tax treatment of exploration expenditure by junior exploration companies.

7.7 CONTRIBUTIONS OF THIS STUDY TO THE ACCOUNTING SCIENCES

This study investigated the accounting and taxation practices of a type of company that increased significantly in number after the promulgation of the MPRDA in 2004, namely, junior exploration companies. These companies form part of the mining sector of the mineral-based economy in South Africa and, thus, merit research. As mentioned in chapter 1 of this study, the

literature available on the accounting and taxation practices of junior exploration companies is limited. Hence, this study contributes to the available literature on these practices. The findings in this study confirmed the need for an IFRS that would address the lack of uniformity in the accounting practices used by junior exploration companies, as this could contribute to an extractive activities project being added to the IASB agenda. Moreover, the study opens up further research opportunities to establish SARS practices in respect of the tax treatment of exploration expenditure by junior exploration companies. Lastly, this study confirmed the need to review the Income Tax Act and special deduction provisions that could influence junior exploration companies' taxation practices; this could result in a possible mining tax review by SARS.

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De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue, 47 SATC 229

Elandsheuwel Farming (Edms) Bpk v Sekretaris van Binnelandse Inkomste, 39 SATC 163

Murchison Exploration and Mining Co Ltd v Commissioner for Inland Revenue, 10 SATC 143

Phalaborwa Mining Company Limited v Secretary for Inland Revenue, 35 SATC 159

Port Elizabeth Municipality v Union Government (Minister of Railways & Harbours) Respondent, 1918 AD 237

Sub-Nigel Ltd v CIR, 15 SATC 381

Western Platinum Limited v Commissioner for SARS, [2004] 4 All SA 611 (SCA)



ACCOUNTING AND TAXATION PRACTICES OF SELECTED MINING EXPLORATION COMPANIES IN SOUTH AFRICA

Dear respondent,

Your company has been considered for participation in an academic research study conducted by Joline Sturdy, a master's student in the accounting sciences under the supervision of Professor Christo Cronjé of the Department of Financial Accounting at the University of South Africa.

The purpose of this study is to determine the accounting and taxation practices of junior exploration companies in South Africa.

The questionnaire aims firstly to obtain response regarding the proposed recommendations made by the discussion paper on extractive activities issued in April 2010 by the International Accounting Standards Board, secondly to establish the accounting policies implemented by junior exploration companies to account for exploration and evaluation cost and lastly to establish the tax consequence of exploration and evaluation cost for junior exploration companies.

The information from the respondents will at all times be treated as confidential and will not be made available to any entity or third party. The data obtained from the questionnaire will be used for academic research purposes only. Your participation in this study is very important and is highly valued. You may, however, choose not to participate and you may also stop participating at any time without any adverse consequences.

An electronic copy of the outcome of this study will be available to all participants. Please follow the link provided and complete the questionnaire if possible before 13 August 2010, which should take approximately 20 minutes. Should you require further information or explanations please contact sturdj@unisa.ac.za or call 084 799 2559. The link to access the web-based questionnaire is:

<http://surveys.unisa.ac.za/index.php?sid=75182&lang=en>

Your responses to the questionnaire would be greatly appreciated. Thanking you in anticipation for your kind cooperation and assistance with this research project.

Yours sincerely,
JOLINE STURDY
26 July 2010

ACCOUNTING AND TAXATION PRACTICES OF SELECTED MINING EXPLORATION COMPANIES IN SOUTH AFRICA

Your company has been considered for participation in an academic research study conducted by Joline Sturdy, a master's student in the accounting sciences under the supervision of Professor Christo Cronjé of the Department of Financial Accounting at the University of South Africa.

Instructions to complete questionnaire:

Please complete all sections of the questionnaire.

You are able to save the questionnaire and resume at a later date.

Please remember there is no right or wrong answers; simply answer the questions based on your knowledge.

Please submit the questionnaire before 13 August 2010.

There are 55 questions in this survey

Consent

1

I understand that the information I have provided below is for academic purposes and will not be used to my disadvantage and therefore do so and give my permission under informed consent.
*

Please choose **only one** of the following:

- Yes
 No. If your response is no, you are requested to provide a brief explanation in the space provided

Make a comment on your choice here:

Biographical Information

<http://surveys.unisa.ac.za/admin/admin.php?action=showprintablesurvey&sid=75182>[2010/08/16 12:44:14 PM]

2 Please provide the company name.

Please write your answer here:

3 What best describes your position in the company?

*

Please choose **only one** of the following:

- Chief Executive Officer / Managing Director
- Chief Financial Officer
- Financial Manager
- Accountant
- Other

4 How many full time employees are currently employed by the company?

*

Please choose **only one** of the following:

- 1 – 10 employees
- 11 – 25 employees
- 25 – 50 employees
- 50+ employees
- None

5 How many years has the company been trading/in business?

*

Please choose **only one** of the following:

- Less than 1 year
- 1-2 years
- 3-5 years
- 5-10 years
- 10+ years

Section 1: New IFRS developments (Discussion paper on extractive activities)

Please comment on the following recommendations made by the project team of the discussion paper (DP) on extractive activities issued in April 2010 by the International Accounting Standards Board (IASB).

6

Scope and approach of extractive activities IFRS:

*

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
The scope of an extractive activities IFRS should only include upstream activities for mineral, oil and natural gas.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
There should be a single accounting and disclosure model that applies to both the mineral industry and the oil and gas industry.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

7

Definitions of reserves and resources:

*

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
The definitions of minerals reserves and resources established by the Committee of Mineral Reserve International Reporting Standards (CRIRSCO) should be used in an IFRS for extractive activities.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The definitions of oil and gas reserves and				

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resources established by the Society of Petroleum Engineers (SPE) should be used in an IFRS for extractive activities.

8
Mineral or oil and gas asset recognition model:
 *

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
The mineral or oil and gas property (asset) is recognised when the legal rights (prospecting right) are acquired.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Information obtained from subsequent exploration and evaluation activities and development works undertaken to access minerals or oil and gas deposits should each be treated as enhancement of the asset.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
The initial unit of account for the asset would be defined according to the geographical area the prospecting rights are held over.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

9
Mineral or oil and gas asset measurement model:
 *

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
The asset should be measured at historical cost.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

10
Impairment of mineral or oil and gas asset:
 *

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

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The asset should be written down to its recoverable amount in those cases where management has enough information to make this determination.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
When information is not available management should write down the asset only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

11
Mineral or oil and gas asset disclosure:

Disclosure objectives for an IFRS for extractive activities should enable users of financial reports to evaluate:
*

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
the value of an entity's mineral or oil and gas property (asset);	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
the contribution of those assets to current period performance;	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
the nature and extent of risks and uncertainties associated with those assets.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

12
Mineral or oil and gas asset disclosure:

Types of information that should be disclosed relating to reserve quantities (Table 5.1 in DP):
*

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
proved and probable reserves	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
estimation methods used	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
main assumptions used	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
sensitivity analysis to main assumptions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
a reconciliation of changes in the estimate	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

of reserves quantities from year to year	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
level of disclosure is by commodity, and broken down by country or project	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

13 Mineral or oil and gas asset disclosure:

The following *current value measurements* information, that corresponds to reserves quantities disclosed, should be disclosed if asset is measured at historical cost (Table 5.1 in DP):
*

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
range of fair value estimates	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
preparation basis	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
main assumptions	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
reconciliation of changes in the current value measurement from year to year;	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

14 Mineral or oil and gas asset disclosure:

Other types of information that should be disclosed :
*

Please choose the appropriate response for each item:

	Strongly Disagree	Disagree	Agree	Strongly Agree
Disclosure of production revenues by commodity.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Separate disclosure of the exploration, development and production costs for the current period and as a time series over a defined period (such as five years).	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

15 Publish What You Pay (PWYP) disclosure:
*

Please choose the appropriate response for each item:

Strongly Disagree	Disagree	Agree	Strongly Agree
-------------------	----------	-------	----------------

Disclose the payments (royalties, taxes, dividends, bonuses, license and concession fees) made by an entity to governments on a country-by-country basis.



16

Comments:

Are there any comments you would like to include with reference to the abovementioned recommendations by the project team of the discussion paper on extractive activities?

Please write your answer here:

Section 2: IFRS 6, Exploration for and evaluation of mineral resources

17

Q1. Has the company started with its exploration activities?

*

Please choose **only one** of the following:

- Yes
- No

18

Q2. Who is performing/going to perform the company's exploration activities?

*

Please choose **only one** of the following:

- The company itself
- External contractor
- Joint Venture (JV)

Other

19

Scope: The IFRS only applies to exploration and evaluation expenditure incurred after the entity has obtained a legal right to explore a specific area (IFRS 6 par.5).

Q3.How does the company treat the following pre-exploration related expenditure?

*

Please choose the appropriate response for each item:

	Asset	Expense	Not applicable
acquisition of third party studies over regions of land	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
acquisition of studies to determine the exploration history of an area	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
preparatory work to prepare exploration teams	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
developing of geological hypotheses	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
application for a prospecting right	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
equipment and infrastructure	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
administration and general overhead costs directly attributable to pre-exploration activities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

20 Accounting policy for exploration and evaluation expenditure:

Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?

*

Please choose **only one** of the following:

- Full expense method (Expense all costs as they are incurred)
- Full cost method (Capitalise all costs)
- Successful efforts method (Expense any costs that are not directly related to a reserve)
- Area of interest method (Identify a geological area and capitalise all costs incurred in proving the area is economically viable or otherwise)
- Expense and reinstate method (Expense all costs as they are incurred; until the reserve is detected; expensed costs then reinstated as an asset)

- Area of interest with provision method (Capitalise all costs associated with area; simultaneously create an equal amount provision. Provision is reversed when area is economically viable)

Section 2: IFRS 6, Exploration for and evaluation of mineral resources

21

Accounting policy for exploration and evaluation expenditure:

Q5. Does the company's accounting policy determine which expenditure is recognised as exploration and evaluation assets (IFRS 6 par.9)?

*

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4. Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

Please choose **only one** of the following:

- Yes
 No

22

Accounting policy for exploration and evaluation expenditure:

Q6. Are the following expenditures included in the initial measurement of the exploration and evaluation assets of the company (IFRS 6 par.9): *

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4. Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

Please choose the appropriate response for each item:

	Yes	No	Not applicable
acquisition of rights to explore	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
topographical, geological, geochemical or geophysical studies	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
exploratory drilling	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
trenching	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
sampling	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
technical feasibility studies	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
exploration staff related costs	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
administration and			

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general overhead costs
directly attributable to
exploration and
evaluation activities

23

Accounting policy for exploration and evaluation expenditure:

Q7.Does the company recognise any obligations for the removal and restoration (rehabilitation) as a consequence of having undertaken the exploration and evaluation of mineral resources (IFRS 6, par.11)?

*

Please choose **only one** of the following:

- Yes
 No
 Not applicable

24

Classification of exploration and evaluation assets:

Q8.Does the company classify exploration and evaluation assets as tangible or intangible assets according to the nature of the assets acquired (IFRS 6 par.15)?

*

Only answer this question if the following conditions are met:

* Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

Please choose **only one** of the following:

- Yes
 No

25

Classification of exploration and evaluation assets:

Q9.How does the company classify the following exploration and evaluation assets: *

Only answer this question if the following conditions are met:

* Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

Please choose the appropriate response for each item:

	Tangible	Intangible	Not applicable
acquisition of rights to explore	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

topographical, geological, geochemical or geophysical studies	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
exploratory drilling	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
trenching	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
sampling	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
technical feasibility studies	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
exploration staff related costs	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
administration and general overhead costs directly attributable to exploration and evaluation activities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
equipment and infrastructure	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Section 2:IFRS 6, Exploration for and evaluation of mineral resources

26

Measurement of exploration and evaluation assets:

Q10. What subsequent measurement model does the company apply to exploration and evaluation assets (IFRS 6 par.12)? *

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

Please choose **only one** of the following:

- Cost
- Revaluation

Section 2:IFRS 6, Exploration for and evaluation of mineral resources

27

Measurement of exploration and evaluation assets:

Q11.Does the company use the prospecting right period to determine the useful life of the intangible exploration and evaluation assets (IAS 38, par.88)? *

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

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Please choose **only one** of the following:

- Yes
- No.If your answer is no, please specify how the company determines the useful life of intangible exploration and evaluation assets.

Make a comment on your choice here:

28

Measurement of exploration and evaluation assets:

Q12.Which ONE of the following methods will best describe the method the company uses to determine the fair value of intangible exploration and evaluation assets.

*

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?) and Answer was 'Revaluation' at question '26 [Sec2_Q10]' (Measurement of exploration and evaluation assets: Q10. What subsequent measurement model does the company apply to exploration and evaluation assets (IFRS 6 par.12)?)

Please choose **only one** of the following:

- Market approach (Uses prices and other relevant information generated in market transactions involving identical or comparable assets)
- Cash flow approach (Calculates fair value by discounting estimated future cash flows)
- Cost approach (The current replacement cost)
- Other

29

Measurement of exploration and evaluation assets:

Q13.Do the company use external consultants to determine the fair value of intangible exploration and evaluation assets?

*

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?) and Answer was 'Revaluation' at question '26 [Sec2_Q10]' (Measurement of exploration and evaluation assets: Q10. What subsequent measurement model does the company apply to exploration and evaluation assets (IFRS 6 par.12)?)

Please choose **only one** of the following:

- Yes
 No

30

Measurement of exploration and evaluation assets:

Q14.Please state how often the company revalues exploration and evaluation assets?

*

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?) and Answer was 'Revaluation' at question '26 [Sec2_Q10]' (Measurement of exploration and evaluation assets: Q10. What subsequent measurement model does the company apply to exploration and evaluation assets (IFRS 6 par.12)?)

Please write your answer here:

31

Impairment of exploration and evaluation assets:

Q15.Does the company test exploration and evaluation assets for impairment?

*

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?)

Please choose **only one** of the following:

- Yes
 No

Section 2:IFRS 6, Exploration for and evaluation of mineral resources

32

Impairment of exploration and evaluation assets:

Q16.Does the company have an accounting policy for allocating exploration and evaluation assets to cash-generating units (CGU) for the purpose of assessing such assets for impairment (IFRS 6, par.21)? *

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?) and Answer was 'Yes' at question '31 [Sec2_Q15]' (Impairment of exploration and evaluation assets: Q15.Does the company test exploration and evaluation assets for impairment?)

Please choose **only one** of the following:

- Yes
 No

33

Impairment of exploration and evaluation assets:

Q17.Do the company use external consultants to determine the recoverable amount of the exploration and evaluation assets or CGU (IAS 36, par.18)? *

Only answer this question if the following conditions are met:

° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?) and Answer was 'Yes' at question '31 [Sec2_Q15]' (Impairment of exploration and evaluation assets: Q15.Does the company test exploration and evaluation assets for impairment?)

Please choose **only one** of the following:

- Yes
 No

34

Impairment of exploration and evaluation assets:

Q18.When does the company test for impairment?

*

Only answer this question if the following conditions are met:

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° Answer was NOT 'Full expense method (Expense all costs as they are incurred)' at question '20 [Sec2_Q4]' (Accounting policy for exploration and evaluation expenditure: Q4.Which ONE of the following methods of accounting for exploration and evaluation expenditure best describes the company's accounting policy?) and Answer was 'Yes' at question '31 [Sec2_Q15]' (Impairment of exploration and evaluation assets: Q15.Does the company test exploration and evaluation assets for impairment?)

Please choose **only one** of the following:

- Each reporting period
- Facts and circumstances suggest impairment
- Other

35 Disclosure:

Q19.Does the company disclose its accounting policy for exploration and evaluation expenditure including the recognition of exploration and evaluation assets (IFRS 6, par. 24)? *

Please choose **only one** of the following:

- Yes
- No

36 Disclosure :

Q20.Does the company disclose the amounts that arise from the exploration for and evaluation of mineral resources for the following elements in the financial statements (IFRS 6, par. 24): *

Please choose the appropriate response for each item:

	Yes	No	Not applicable
assets	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
liabilities	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
income	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
expense	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
operating cash flows	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
investing cash flows	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

37 Disclosure:

Q21.Does the company disclose information in its financial statements relating to its resources and/or reserves? *

Please choose **only one** of the following:

- Yes
- No

Section 2:IFRS 6, Exploration for and evaluation of mineral resources

38 Disclosure:

Q22.Does the company use the South African Mineral Resource Committee (SAMREC) code for guidance on the reporting of its resources and/or reserves? *

Only answer this question if the following conditions are met:

* Answer was 'Yes' at question '37 [Sec2_Q21]' (Disclosure: Q21.Does the company disclose information in its financial statements relating to its resources and/or reserves?)

Please choose **only one** of the following:

- Yes
- No.If your answer is no, please specify which code, if any, the company uses for guidance on the reporting of its resource and/or reserves.

Make a comment on your choice here:

Section 3:Application of the Income Tax Act (ITA) to junior exploration companies

39

Q1.What is/was the dominant intention of the exploration company in obtaining prospecting rights? *

Please choose **only one** of the following:

- Speculative purposes
- To establish a mine
- Enter into royalty agreement

Section 3:Application of the Income Tax Act (ITA) to junior exploration

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companies

40

Q2.Does the company have a mining right/s?

*

Please choose **only one** of the following:

- Yes
 No

41

Prospecting / exploration expenditure:

Q3.In terms of the ITA how does/did the company classify the nature of its prospecting/exploration expenditure?

*

Please choose **only one** of the following:

- Revenue nature
 Capital nature

42

Prospecting / exploration expenditure:

Q4.Which section in the ITA does / did the company utilise for its prospecting/exploration expenditure? *

Please choose **only one** of the following:

- Section 11(a) (General deductions allowed in determination of taxable income)
 Section 15(a) and Section 36 (Capital expenditure allowances in connection with mining operations)
 Section 15(b) (Expenditure incurred on prospecting operations)
 Par. 20(1)(a) of the Eighth Schedule (Base cost of asset)
 Other

Section 3:Application of the Income Tax Act (ITA) to junior exploration companies

43

Prospecting / exploration expenditure:

Q5.Does/did the company consider prospecting/exploration expenditure incurred as trading stock (Section 22 of the ITA)?

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*

Please choose **only one** of the following:

- Yes
 No

44

Mining income:

Q6.How does/did the company classify its royalty income from prospecting rights in terms of the ITA?

*

Only answer this question if the following conditions are met:

° Answer was 'Enter into royalty agreement' at question '39 [Sec3_1]' (Q1.What is/was the dominant intention of the exploration company in obtaining prospecting rights?)

Please choose **only one** of the following:

- Mining income
 Non-mining income

45

Mining income:

Q7.Does the company earn any mining income as defined by the ITA?

*

Please choose **only one** of the following:

- Yes
 No

46

Mining income:

Q8.Does the company earn any non-mining income? *

Please choose **only one** of the following:

- Yes
 No

Section 3:Application of the Income Tax Act (ITA) to junior exploration companies

<http://surveys.unisa.ac.za/admin/admin.php?action=showprintablesurvey&sid=75182>[2010/08/16 12:44:14 PM]

47

Mining income:

Q9. According to the company's tax assessment, did the South African Revenue Services (SARS) limit the deduction allowed according to Section 15(b) to the mining income of the company?

*

Only answer this question if the following conditions are met:

° Answer was 'Section 15(b) (Expenditure incurred on prospecting operations)' at question '42 [Sec3_Q4]' (Prospecting / exploration expenditure: Q4. Which section in the ITA does / did the company utilise for its prospecting/exploration expenditure?) and Answer was 'Yes' at question '45 [Sec3_Q7]' (Mining income: Q7. Does the company earn any mining income as defined by the ITA?)

Please choose **only one** of the following:

- Yes
- No
- Have not yet received assessment from SARS

48

Mining income:

Q10. According to the company's tax assessment, did the South African Revenue Services (SARS) allow the deduction according to Section 15(b) against the non-mining income of the company?

*

Only answer this question if the following conditions are met:

° Answer was 'Section 15(b) (Expenditure incurred on prospecting operations)' at question '42 [Sec3_Q4]' (Prospecting / exploration expenditure: Q4. Which section in the ITA does / did the company utilise for its prospecting/exploration expenditure?) and Answer was 'No' at question '45 [Sec3_Q7]' (Mining income: Q7. Does the company earn any mining income as defined by the ITA?) and Answer was 'Yes' at question '46 [Sec3_Q8]' (Mining income: Q8. Does the company earn any non-mining income?)

Please choose **only one** of the following:

- Yes
- No
- Have not yet received assessment from SARS

49

Mining income:

Q11. According to the company's tax assessment, did the South African Revenue Services (SARS) allow the deduction according to Section 15(b) to be carried forward as either an *

Only answer this question if the following conditions are met:

° Answer was 'Section 15(b) (Expenditure incurred on prospecting operations)' at question '42 [Sec3_Q4]' (Prospecting / exploration expenditure: Q4. Which section in the ITA does / did the company utilise for its prospecting/exploration expenditure?) and Answer was 'No' at question '45 [Sec3_Q7]' (Mining income: Q7. Does the company earn any mining income as defined by the ITA?) and Answer was 'No' at question '46 [Sec3_Q8]' (Mining income: Q8. Does the company earn any non-mining income?)

Please choose **only one** of the following:

<http://surveys.unisa.ac.za/admin/admin.php?action=showprintablesurvey&sid=75182>[2010/08/16 12:44:14 PM]

- Assessed loss
- Unredeemed capital expenditure
- Have not yet received assessment from SARS

50

Disposal of prospecting rights:

Q12.Has the company disposed any of its prospecting rights?

*

Please choose **only one** of the following:

- Yes
- No

Section 3:Application of the Income Tax Act (ITA) to junior exploration companies

51

Disposal of prospecting rights:

Q13.Did the company apply Section 37 (calculation of capital expenditure on sale of mining property) of the ITA?

*

Only answer this question if the following conditions are met:

° Answer was 'Yes' at question '50 [Sec3_Q12]' (Disposal of prospecting rights: Q12.Has the company disposed any of its prospecting rights?)

Please choose **only one** of the following:

- Yes
- No

52

Disposal of prospecting rights:

Q14.With the disposal of the prospecting rights, did the company apply the Eight Schedule to the ITA ?

*

Only answer this question if the following conditions are met:

° Answer was 'Yes' at question '50 [Sec3_Q12]' (Disposal of prospecting rights: Q12.Has the company disposed any of its prospecting rights?)

Please choose **only one** of the following:

- Yes
- No

<http://surveys.unisa.ac.za/admin/admin.php?action=showprintablesurvey&sid=75182>[2010/08/16 12:44:14 PM]

53

Other tax matters:

Q15.Does the company utilise Section 37A (environmental contributions) of the ITA?

*

Please choose only one of the following:

- Yes
 No

54

Other tax matters:

Q16.Is the company registered with the Commissioner in accordance with Section 2 of the Mineral and Petroleum Resources Royalty (Administration) Act?

*

Please choose only one of the following:

- Yes
 No

55

Other tax matters:

*

Please choose the appropriate response for each item:

	Yes	No	I don't Know
Will the company have to pay any royalties in accordance with the Mineral and Petroleum Resources Royalty Act in 2010/2011?	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Is a venture capital company (VCC) as defined by Section 12J (Deductions in respect of expenditure incurred in exchange for issue of venture capital company shares) of the ITA a shareholder of the company?	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Does the company qualify as an investment for a VCC			

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in accordance with
Section 12J of the
ITA?

Do you think Section
12J of the ITA will
improve local financing
of junior exploration
companies?

01.01.1970 – 02:00

Submit your survey.

Thank you for completing this survey.