


Refining IFRS

IFRS financial reporting issues in the mining and metals sector

UPDATE: Accounting for stripping costs - draft interpretation

January 2011



Our *Refining IFRS* series examines the complex and unique issues faced by mining and metals companies in the application of IFRS. These issues are considered in the context of recent and current developments in the global mining and metals market place. This edition of *Refining IFRS* provides an update of the IFRS Interpretations Committee's deliberations on accounting for stripping costs.

Introduction

In late 2009, the IFRS Interpretations Committee (Interpretations Committee) received a request for guidance in relation to the accounting for surface mine stripping costs incurred during the production phase. This request arose from the lack of specific guidance currently available in IFRS and the significant diversity thought to exist in practice. In August 2010, the Interpretations Committee published for public comment a Draft Interpretation *Stripping Costs in the Production Phase of a Surface Mine* (Draft Interpretation).

At the January 2011 meeting, the staff presented a summary of the comments received on the Draft Interpretation to the Interpretations Committee. The Interpretations Committee discussed the issues raised by the respondents and agreed to continue deliberating the Draft Interpretation.

This edition of *Refining IFRS* provides a high-level overview of the discussions from this meeting and outlines the issues that will be taken back to the March 2011 meeting. We also set out our understanding of the likely next steps and the anticipated timing of this Interpretation being finalised.

Scope

The Draft Interpretation only applies to waste removal (stripping) costs incurred in surface mining activity during the production phase of the mine. Development phase stripping is not considered and will continue to be capitalised in accordance with IAS 16 *Property, Plant and Equipment*.

Outcome of the discussions

In the January 2011 meeting, the Interpretations Committee staff asked a number of questions of the Interpretations Committee regarding the next steps. Below, we outline the Interpretations Committee's responses to each of these questions.

Should the Interpretations Committee continue with developing this Interpretation?

Some respondents to the Draft Interpretation challenged whether an interpretation was actually needed on this matter. This was on the basis that they considered that either:

- ▶ Stripping costs could be adequately accounted for by applying the principles in IAS 16 *Property, Plant and Equipment* or
- ▶ Current diversity in practice is "due to the underlying geological differences in mines, and may not be resolved by the development of principles around accounting for production stripping costs"¹

The Interpretations Committee concluded that it should continue with this interpretation, because:

- ▶ Diversity in practice does exist and will become greater as Canada adopts IFRS (and possibly the US, which expenses production period stripping costs)
 - ▶ Guidance needs to be given as to whether and when the life-of-mine stripping ratio method would be acceptable
- And
- ▶ IAS 16 and IAS 38 *Intangible Assets* currently exclude mineral rights and reserves from their scope

Should the Interpretations Committee continue to distinguish between routine stripping costs and stripping costs incurred during a stripping campaign?

Generally, most respondents indicated they did not believe the definition of a stripping

campaign satisfactorily distinguished between a stripping campaign and routine waste clearing activities. Many respondents also questioned whether it was actually necessary to distinguish between the two. The Interpretations Committee staff presented three possible approaches to this question:

- a) Yes, the distinction is necessary, but clarify the definition of "stripping campaign" and provide a definition for "routine" stripping costs.
- b) No, remove the distinction - capitalise all costs that meet the definition of an asset, without distinguishing between routine and stripping campaign costs.
- c) No, remove the distinction - capitalise all stripping costs incurred during a period

The Interpretations Committee preferred approach b) above. Consequently, they asked the staff to prepare a description of the principle for the capitalisation of production stripping costs, that did not require definition of or reference to the term 'stripping campaign'. They also requested the staff to include guidance on the apportionment of costs incurred between:

- ▶ Ore that is mined in the period (inventory)
- And
- ▶ The improved access to ore to be mined in the future (long-term asset)

How we see it

We believe it is appropriate to apply one principle to all production phase stripping activity and not distinguish between routine stripping and a stripping campaign.

Should the Interpretation state that capitalised stripping costs must be accounted for as assets under IAS 16, and remove the choice between IAS 16 and IAS 38?

While the Draft Interpretation did not address the issue of the classification of capitalised stripping costs, many respondents supported the accounting for stripping costs under the principles of IAS 16, and not as intangible assets under IAS 38 *Intangible Assets*. Given this response, the Interpretations Committee was

¹ IASB staff paper "Accounting for stripping costs in the production phase of a surface mine - comment letter analysis" January 2011

asked whether IAS 16 should be mandated and the choice between the two standards removed.

The Interpretations Committee decided to keep the choice open. This was on the basis that a stripping cost asset would not be considered an asset in its own right, but, instead, would be an addition to/enhancement of an underlying asset, which could be PP&E, inventory or an unrecognised asset (e.g., rights under an operating lease or unrecognised mineral reserves). Given this decision, it would not be appropriate to mandate a particular standard.

How we see it

While we believe it is appropriate to continue to provide a choice as to which standard to apply, we believe the stripping campaign component will most likely be classified as a tangible asset as it relates to mine properties (akin to land) or mineral reserves. Hence, IAS 16 is likely to be the more relevant standard.

Should the Interpretation continue to require depreciation/amortisation according to the specific identification approach?

There were mixed responses to the appropriateness of the specific identification approach for depreciation/amortisation purposes.

To this end, the staff presented three possible approaches for the Interpretations Committee to consider:

- a) Yes, continue to recommend the specific identification approach- with additional guidance to allow more flexibility in light of the practical problems identified
- b) Yes, continue to recommend the specific identification - but with the proviso that if the approach was unreasonably difficult to apply then to revert to a "systematic and rational" approach under IAS 16 (this would permit the life of mine approach)
- c) No, do not continue to recommend the specific identification - leave it to IAS 16

The Interpretations Committee decided to proceed with approach a).

How we see it

While we conceptually agree with the approach chosen by the Interpretations Committee, we specifically noted in our response that the stripping cost components should be allocated to those sections of the ore body that become, or will ultimately become, accessible as a result of removing the waste. This is because they would not just relate to that part of the ore body that is "directly accessible". We understand that the Interpretation will be modified to cater for this.

We also note that it may be difficult to develop practical guidance for use by all companies, when applying the specific identification approach. This is due to the many different types of ore bodies, mining methods, systems and availability of data.

How should the Interpretations Committee proceed with the transition requirements?

The Draft Interpretation addressed a number of transitional issues, including:

- ▶ The date from which the final interpretation should apply
- And
- ▶ How any deferred stripping asset or liability (if applicable) existing at transition date should be accounted for

The Interpretations Committee did not address transition during the January meeting. It has decided to wait until the next draft of the amended Interpretation is discussed.

Other issues

A number of other issues were raised by the respondents in their letters, which the staff believed the Interpretations Committee should consider further.

Illustrative example

Many respondents raised concerns that the illustrative example included in the Draft Interpretation was too simplistic and not representative of surface mines. Given this, the staff asked the Interpretations Committee whether the example should be removed from the final interpretation.

As a result, the Interpretations Committee agreed to remove the illustrative example.

Impairment of a component

Some respondents indicated that the impairment requirements within the Draft Interpretation need clarification. Specifically, they wanted to know whether the stripping campaign component, or the cash generating unit (CGU) to which it belonged, would be assessed for impairment.

The Interpretations Committee did not discuss this issue in this meeting. This will be discussed at the March 2011 meeting.

Definition of the 'production phase':

Some respondents suggested that the Draft Interpretation should include a definition of the production phase of a mine, since this is the scope of the guidance. The respondents stated that the transition between the production phase and other phases of a mine's life cycle is a fine line to define in practice, and guidance in the Interpretation would be useful².

However, the Interpretations Committee concluded that it would not provide such a definition as the industry had already determined this.

How we see it

We agree that this interpretation would not be an appropriate place to define the production phase. Given the potential impact such a definition would have on other areas of accounting, e.g., capitalisation of other costs, commencement of depreciation/amortisation, revenue recognition, etc., determining an acceptable definition would require significant research and consultation, which would lead to substantial delays in the finalisation of this interpretation.

Next steps

The staff will update the Draft Interpretation based on the discussions at the January meeting and will present an updated draft at the March 2011 meeting.

How we see it

Given the number of issues still to be considered and agreed by the Interpretations Committee, it is unlikely this interpretation will be finalised at the March 2011 meeting. Instead, this is more likely to occur at the May 2011 meeting.

It is also our understanding that while the interpretation may change, it is unlikely to be re-exposed.

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² IASB staff paper "Accounting for stripping costs in the production phase of a surface mine - comment letter analysis" January 2011

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