

# Mining and Metals Refining IFRS



## Proposals to clarify the accounting for surface mine stripping costs incurred during the production phase

Our Refining IFRS series aims to examine the complex, but unique, issues faced by mining and metals companies applying IFRS. These issues are considered in the context of recent and current developments in the global mining and metals market place.

There is, currently, diversity in practice when accounting for the removal of overburden and waste materials (also known as stripping) incurred in mining activities. In recent months, the IFRS Interpretations Committee (the Interpretations Committee) has been considering the issue of accounting for stripping costs incurred in the production phase of a mine. While the issue is within the scope of the International Accounting Standard Board's (IASB's) current extractive activities project, the Interpretations Committee noted that the project would not provide guidance on the issue in the foreseeable future. For this reason, an interpretation has been developed and, on 26 August 2010, the Interpretations Committee released their draft interpretation (DI) for comment.

### Current practice in accounting for stripping costs

During the development of a mine, that is before production commences, it is generally accepted that the cost of stripping should be capitalised as part of the investment in the construction cost of the mine. However, no consensus exists regarding the treatment of stripping costs incurred during the production phase ('production stripping'). The September 2009 edition of Ernst & Young's *Mining and Metals Refining IFRS* provides an overview of the accounting practices that are currently applied by IFRS reporters.

## Key features of the draft interpretation

### *What is the scope of the interpretation?*

The DI only applies to stripping costs incurred in surface mining activity during the production phase of the mine. Development phase stripping is not affected and will continue to be capitalised.

### How we see it

The term 'production phase' is not defined in the DI. If it was, it may have had other consequences. For example, if the Interpretations Committee had defined the production phase, it may have influenced the date at which other costs were required to cease being capitalised (e.g., other development costs, borrowing costs) and the start date of the depreciation or amortisation of mining assets.

The absence of a definition is interesting given this very issue, i.e., when a mine moves from development to production, it tends to be one of the most interpretative areas of IFRS, and often also leads to divergence in practice. Continued judgement will be required when working with this concept.

### *The stripping campaign*

One of the critical concepts included in the DI is the stripping campaign. The DI considers a stripping campaign to be a systematic process undertaken to gain access to a specific section of the ore base. It is typically planned in advance and forms part of the mine plan.

The DI recognises that determination of a stripping campaign will require judgement.

The DI also addresses the concept of routine stripping costs. These costs relate generally to the stripping activity just ahead or around the ore to facilitate

production. The conclusion reached by the Interpretations Committee was that routine stripping costs should be expensed as current costs.

### How we see it

Judgement in assessing what constitutes a stripping campaign will have to be considered by the entity. It is likely that advance planned removal of overburden and waste material to allow access to a specific ore body, for many open pit mining operations, could qualify as stripping campaigns. However, concepts currently considered in practice, such as the impact of specific geological conditions that create variations in stripping ratios, such as temporary increases in the number of waste blocks to ore blocks in a particular bench, within a particular period, have not been considered by the DI. The recommendations of the DI could well lead to a substantial impact on the financial statements of mining entities.

### *Is the definition of an asset met?*

By undertaking stripping activities (and incurring stripping costs), the Interpretations Committee concluded that there is a benefit to the mine through the improved access to the ore body. Further, the Interpretations Committee concluded that the benefit would meet the definition of an asset in the *Framework*. That is, the stripping costs would be considered a 'resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity'.

There are three possible options:

- ▶ The benefit does not meet the definition of an asset and therefore such costs shall be expensed and included as an operating cost in the current reporting period.

- ▶ The benefit meets the definition of an asset but the stripping activity benefits the current period only (e.g., routine stripping costs not incurred as part of a stripping campaign). The stripping costs would be considered a component of the cost of inventory produced in the current reporting period and shall be accounted for in accordance with IAS 2 *Inventories*.
- ▶ The benefit meets the definition of an asset and is considered to benefit a future reporting period. The costs of such stripping activity shall be accounted for as an addition to, or enhancement of, an existing asset. In other words, this benefit will become a component of an existing asset, and is referred to in the DI as the 'stripping campaign component'.

However, the Interpretations Committee also decided that it was not necessary to establish the nature of the asset. Rather, this would form a component of the underlying asset with which the benefits are associated. Hence, ultimately the stripping costs could form part of either a tangible or intangible asset.

#### **How we see it**

The stripping campaign component will usually be classified as a tangible asset as it relates to mine properties (akin to land) or mineral reserves, both of which are usually classified as tangible assets. In rare circumstances, production stripping will occur for the production of resources which will be classified as an intangible asset.

#### ***When should the asset be initially recognised?***

A stripping campaign component asset is recognised as the stripping activity takes place and the costs of creating that asset are incurred. Recognition will cease when the stripping campaign ends, that is, when waste removal activity

necessary to access the ore with which the campaign is associated is completed.

#### ***How should the asset be measured initially?***

The stripping campaign component would be initially measured at cost. This would include an allocation of directly attributable costs. Examples of such costs would be drill and blast, haulage, materials consumed, costs of plant employed, labour and fuel costs. In some instances, incidental operations may simultaneously occur to further prepare the mine for production, but are not necessary for the stripping campaign to continue as planned.

An example would be building a general access ramp in the area in which the stripping campaign is taking place. The costs associated with these ancillary operations shall not be included in the cost of the stripping campaign component. These ancillary costs shall be recognised as assets or expensed in accordance with other IFRSs.

#### ***How should the asset be subsequently measured?***

After initial recognition, the stripping campaign component would be measured at its cost less depreciation or amortisation, and less any impairment losses.

The depreciation or amortisation of the stripping campaign component would occur in a rational and systematic manner over the reserves that become available as a result of the stripping campaign.

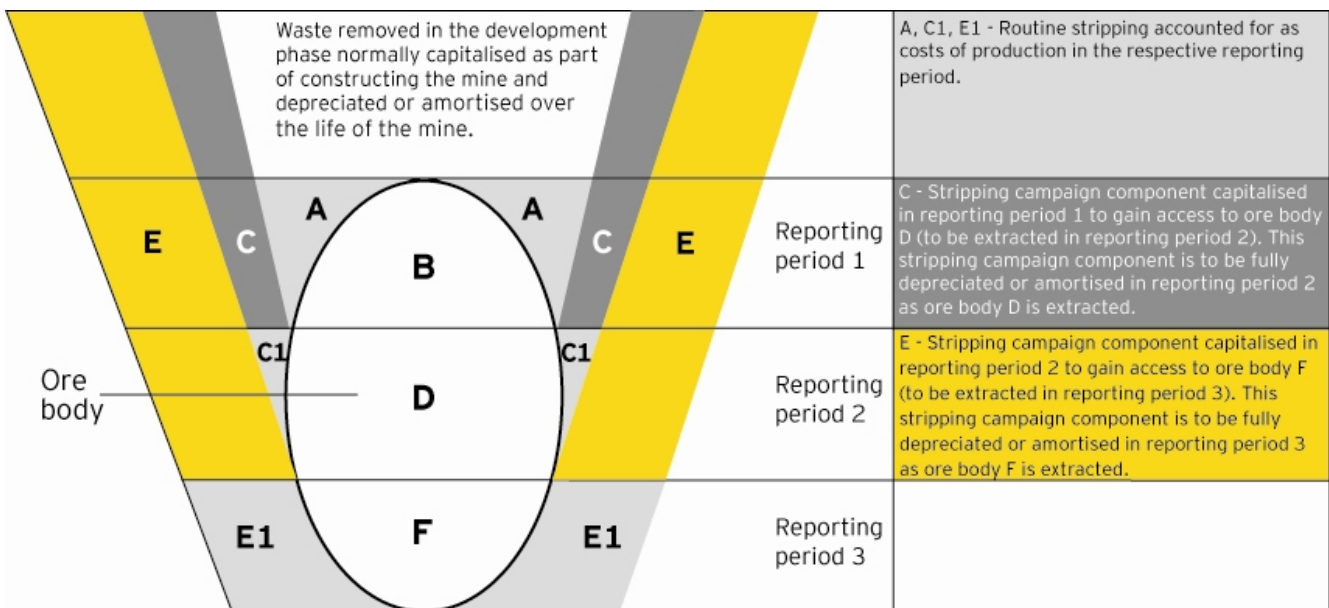
#### **How we see it**

In the mining industry, the units of production method is generally considered to be the most appropriate method. However, the DI does not restrict depreciation or amortisation only to this method.

The DI notes that the expected useful life of the specific section of ore used to depreciate or amortise the stripping campaign component may differ from that used to depreciate or amortise the mine and related life-of-mine assets. This is due to the stripping campaign being specific to providing access to a particular portion of the ore body.

The following diagram illustrates the DI's principles:

Such a balance would be depreciated or amortised over the remaining specific ore quantity to which the stripping activity relates. If there is no identifiable ore quantity to which that component can be associated, it would be written off against profit or loss immediately. In the case of an existing stripping cost liability balance, this would be recognised in profit or loss at the beginning of the earliest period presented.



### Effective date and transition

No effective date has been published in the DI; however, early application will be allowed with disclosure of that fact.

### Next steps

The DI will be open for public comment until 30 November 2010.

Given the aim of a Committee interpretation is to limit divergence, it is likely that many entities will need to change their current accounting policies and procedures for stripping costs.

### Transition

When effective, the DI would be applied prospectively to production stripping costs incurred on or after the beginning of the earliest period presented.

At the date of the beginning of the earliest period presented, any stripping cost asset balance that resulted from stripping activity undertaken during the production phase will be reclassified as a component of the asset to which the stripping activity relates.

### How we see it

As part of the development of the DI, the Interpretations Committee has consulted amongst mining companies and other interested parties. Now that the DI has been exposed, and given the potential impact it may have on the financial position and results of operations, it is important that entities provide comments to the Interpretations Committee.

## Business impact

Depending upon the previous accounting policies, entities will need to change their existing accounting policies and procedures for stripping costs. Despite the guidance provided in the DI, diversity and complexities will still exist. For example:

- ▶ Determining which quantity of ore relates to past campaigns that now comprise the deferred stripping asset balance at the date of transition. The inability to appropriately identify this will require entities to expense this balance immediately. This may have a significant impact on their results at the date of transition.
- ▶ Clearly identifying each current and future stripping campaign.
- ▶ Determining which section of ore these campaigns are associated.

Changes to the relevant systems and process that will enable each of the various types of stripping costs (outlined above) to be accumulated and amortised.

Given the complexities associated in applying its provisions, entities should review their current processes and procedures and identify what amendments will be required to ensure they will be compliant. This will also involve communicating to various stakeholders the likely impact on future earnings.

Mining entities should start to immediately track the association between historic deferred stripping together with stripping incurred before the effective date of the DI, with expected ore production. This information is required to allow for continued deferral of any related asset as at that date of transition.

## **Ernst & Young's Global Mining & Metals Center**

With a strong outlook in the sector, the global mining and metals industry is focused on future growth through expanded production, without losing sight of operational efficiency and cost optimization. The sector is also faced with the increased challenge of changing expectations in the maintenance of its social license to operate and meeting government revenue expectations.

Ernst & Young's Global Mining & Metals Center brings together a worldwide team of professionals to help you achieve your potential - a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector.

The Center is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow. Ultimately it enables us to help you meet your goals and compete more effectively. It's how Ernst & Young makes a difference.

### **Global Mining & Metals and Australia Leader**

Mike Elliott  
Tel: +61 2 9248 4588  
michael.elliott@au.ey.com

### **China**

Peter Markey  
Tel: +86 21 2228 2616  
peter.markey@cn.ey.com

### **Japan**

Kentaro Nakamichi  
Tel: + 81 3 5401 6407  
kentaro.nakamichi@jp.ey.com

### **Europe, Middle East, India and Africa Leader**

Michael Lynch-Bell  
Tel: +44 20 7951 3064  
mlynchbell@uk.ey.com

### **Africa**

Adrian Macartney  
Tel: +27 11 772 3052  
adrian.macartney@za.ey.com

### **Commonwealth of Independent States**

Evgeni Khrustalev  
Tel: +7 495 648 9624  
evgeni.khrustalev@ru.ey.com

### **France and Luxemburg**

Christian Mion  
Tel: +224 30 41 21 82  
christian.mion@fr.ey.com

### **India**

Anjani Agrawal  
Tel: +91 982 061 4141  
anjani.agrawal@in.ey.com

### **United Kingdom**

Lee Downham  
Tel: +44 20 7951 2178  
ldownham@uk.ey.com

### **Americas and United States Leader**

Andy Miller  
Tel: +1 314 290 1205  
andy.miller@ey.com

### **Canada**

Tom Whelan  
Tel: +1 604 891 8381  
tom.s.whelan@ca.ey.com

### **South America and Brazil Leader**

Carlos Assis  
Tel: +55 21 2109 1606  
carlos.assis@br.ey.com

### **Argentina**

Pablo Decundo  
Tel: +54 11 4515 2684  
pablo.decundo@ar.ey.com

### **Colombia**

Joss McGregor  
Tel: +57 1 484 7120  
joss.mcgregor@co.ey.com

### **Chile**

Alicia Dominguez  
Tel: +56 2 676 1207  
alicia.dominguez@cl.ey.com

### **Peru**

Marco Antonio Zaldivar  
Tel: +5711 411 4450  
marco-antonio.zaldivar@pe.ey.com

Ernst & Young

Assurance | Tax | Transactions | Advisory

### **About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 144,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organisation of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

For more information about our organization, please visit [www.ey.com](http://www.ey.com).

© 2010 EYGM Limited. All Rights Reserved.  
EYG No. AU0614

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

[www.ey.com/miningmetals](http://www.ey.com/miningmetals)