

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2010/20

STRIPPING COSTS IN THE PRODUCTION PHASE OF A SURFACE MINE



Background

The IFRS Interpretations Committee (the Committee), the interpretative body of the International Accounting Standards Board (the IASB), has published a Draft Interpretation (the DI) of proposed guidance on the accounting for stripping costs in the production phase of a surface mine.

In surface mining operations, entities may find it necessary to remove mine waste materials (overburden) to gain access to mineral ore deposits. This waste removal activity is known as 'stripping'. During the development phase of the mine (before production begins), stripping costs are usually capitalised as part of the cost of building, developing and constructing the mine. Those capitalised costs are depreciated or amortised over the life of the mine using the units of production method, once production begins.

A mining entity may continue to remove overburden and to incur stripping costs during the production phase of the mine. These costs may be part of the routine costs incurred during production. Production stripping costs may also be incurred in gaining access to a specific section of the ore body. The proposed DI refers to these activities as a 'stripping campaign'. A stripping campaign is described in the DI as a systematic process undertaken to gain access to a specific section of the ore body, which is a more aggressive process than routine waste clearing activities. The stripping campaign is planned in advance and forms part of the mine plan. It will have a defined start date and it will end when the entity has completed the waste removal activity necessary to access the ore with which the campaign is associated. In practice, the deposit of ore in an open pit mine is usually exposed in a series of 'push-backs', where waste is stripped and the ore is mined in a phased manner. Mine planning will identify the number, extent and timing of 'push-backs' required over the life of the mine. The number, timing and extent of the stripping campaigns will depend upon a number of factors, e.g. maximising the productivity of the capital equipment and labour force, safety factors such as slope stability, characteristics of the ore body and scheduling of production to meet demand.

The Committee was asked to consider how to account for stripping costs given the divergence that exists in practice. Some entities recognise production stripping costs as an expense (a cost of production), and some entities capitalise some or all production stripping costs, on the basis of a life-of-mine ratio calculation, or some similar basis, and some capitalise the costs associated with specific improvements.

STATUS

Draft IFRIC Interpretation

EFFECTIVE DATE

To be confirmed

ACCOUNTING IMPACT

Significant changes proposed for recognition and presentation of stripping costs in the production phase of a surface mine

Proposals

Scope

The proposed DI applies to waste removal (stripping) costs that are incurred in surface mining activity, during the production phase of the mine. The proposed DI does not include oil and natural gas extraction and underground mining activities as the Committee understood that stripping activity occurs predominantly in surface mining activities, and hence decided to confine the scope to these circumstances. The Committee also decided not to include stripping costs incurred during the development phase of the mine, because the Committee became aware that there is not significant diversity in practice in this regard.

Issues

The DI addresses the following issues:

- (a) Is the definition of an asset met?
- (b) When should the stripping campaign component be recognised?
- (c) How should the stripping campaign component be measured initially?
- (d) How should the stripping campaign component be measured subsequently?

Is the definition of an asset met?

The Committee concluded that an entity creates a benefit by undertaking stripping activity, with this being improved access to the ore to be mined. An ore body that has been cleared of waste is more valuable to an entity than one where less or no waste has been removed. Access to the ore body therefore becomes easier and less costly. Therefore, an entity is required to assess whether the benefit meets the definition of an asset set out in the Framework. Paragraph 49(a) of the Framework states that 'an asset is 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.' The proposed DI notes that the benefit of improved access to the ore will qualify for recognition as part of (a component of) an existing asset when:

- (a) an entity controls the benefit created by the stripping activity, either by owning the land that it is mining, or by owning the rights to mine the land;
- (b) the benefit arises as a result of stripping activity, and consequently 'as a result of past events'; and
- (c) a future economic benefit will flow to an entity through improved access to the ore that is expected to be economically recoverable in the future.

A distinction is made between stripping activity that is 'routine', and stripping activity that takes the form of a systematic process to gain access to a specific section of the ore body – the latter is referred to in the draft Interpretation as a 'stripping campaign'. The proposed DI includes illustrative examples in order to illustrate the difference between a stripping campaign and routine stripping activities, and also to clarify the concept of specific identification of a section of the ore body for the purposes of depreciation or amortisation.

The DI proposes that the costs of stripping activity that are part of a stripping campaign are accounted for as an addition to, or an enhancement of, an existing asset. In other words, this benefit will become a component of an existing asset, and is referred to in this DI as the 'stripping campaign component'. The basis for conclusions note that a stripping campaign will involve a significant 'push-back' or removal of waste material in order to widen or deepen an existing pit, or to create a new satellite pit. This activity is likely to have an enduring benefit – the area that has been accessed as a result may be mined over a number of future periods – and consequently, the recognition criteria for an asset will usually be met. Although distinguishing a stripping campaign from routine stripping activities will require judgement it is considered that entities generally plan for stripping campaigns well in advance and that such campaigns are typically well enough defined to determine whether particular activities are part of routine stripping or a stripping campaign.

The DI proposes that routine stripping costs that are not incurred as part of a stripping campaign are accounted for as current costs of production in accordance with IAS 2. The basis for conclusions note that most surface mining operations will undertake routine stripping activity continuously just ahead of, or around, the ore currently being mined, to ensure that production continues without delay. The benefit created by routine stripping is unlikely to extend beyond the current reporting period, because the ore being uncovered as a result is likely to be mined in the current reporting period, and no potential future benefit to the entity exists. There will be some circumstances when routine stripping may create a benefit that will be realised in a future period. This may arise, for example, when stripping is performed continuously as part of routine operations, and continues into the following reporting period. However, the Committee decided that the costs of such routine stripping should not be recognised as part of an asset.

The DI proposes that the stripping campaign component of an asset is classified as tangible or intangible according to the nature of the existing asset to which it relates. It is noted in the basis for conclusions that the benefit might add to, or improve, a variety of existing assets, for example the mine property (land), the mineral deposit itself, an intangible right to extract the ore, or an asset that originated in the mine development phase. The Committee decided that it is not necessary for the Interpretation to define whether the benefit created by stripping activity is tangible or intangible in nature because this will follow from the nature of the underlying asset to which the benefit relates. Furthermore, the stripping campaign component is required to be specifically associated with the section of ore that becomes directly accessible as a result of the stripping activity. At the same time as the component is recognised, it is important that the entity should link the costs incurred to the section of the ore body that will be accessed as a result of the stripping campaign. This is because of the linkage to the subsequent depreciation or amortisation of the asset, which will take place as the ore is mined.

Recognition

The DI proposes that the stripping campaign component of an asset is recognised when the stripping activity takes place and the costs of creating the stripping campaign component are incurred. A mine may have one or more stripping campaigns planned into the production phase. Recognition of the stripping campaign component ceases when the entity has completed the waste removal activity necessary to access the ore to which the campaign relates. This approach is based on a similar principle to that in IAS 16.20 in determining when the recognition of costs of a stripping campaign component should end. IAS 16.20 states that recognition should cease when the item is 'in the location and condition necessary for it to be capable of operating in the manner intended by management'. An entity incurs stripping costs with the ultimate goal of extracting ore from the land. Consequently, once a section of land is stripped to the extent required in order to achieve this goal, recognition of stripping costs as part of the capitalised amount of that section of land should cease. Subsequent stripping costs should be separately assessed to determine whether they represent routine stripping (which will be expensed as incurred), or a new stripping campaign (in which case they may be eligible to be capitalised).

Initial Measurement

The DI proposes that the stripping campaign component is measured initially at cost, being costs directly incurred to perform the stripping activity and an allocation of directly attributable costs. If incidental operations take place at the same time as the stripping activity, but are not necessary for the stripping campaign to continue as planned, these costs are not included in the cost of the stripping campaign component. The principle in IAS 16.21 is applied to determine whether incidental costs should be included in the measurement of the stripping campaign component. In addition, other development activities may take place at the same time and in the same area as the stripping activity, but not be of a waste removal nature. Similarly to the costs associated with incidental operations, ancillary costs are not capitalised as part of the stripping campaign component.

Subsequent Measurement

The DI proposes that after initial recognition, the stripping campaign component is carried at its cost less depreciation or amortisation, and less any impairment losses. The 'units of production method' is applied unless another method is more appropriate. The expected useful life of the specific section of the ore body that is 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, because the stripping campaign will give access only to a portion of the total ore body. Because the life of the stripping campaign is usually a subset of the entire life of the mine, the stripping campaign component will be depreciated or amortised over a lesser period than the life of the mine. It is not expected that a stripping campaign would last the duration of the entire mine. In addition, an entity should consider the stripping campaign component for impairment in accordance with IAS 36. Suspension (or planned suspension) of the extraction of the ore that is specifically associated with the stripping campaign component is an indication that the component may be impaired.

Transition

It is proposed that an entity would apply the final interpretation to production stripping costs incurred on or after the beginning of the earliest period presented. Because of the complex and lengthy nature of many mining operations, and the diversity of practice in respect of this issue, the Committee concluded that the cost of applying the change in accounting policy retrospectively would exceed the benefit to be gained in doing so.

It is also proposed that each existing stripping cost asset balance as at the date from which the final interpretation is applied, that resulted from stripping activity undertaken during the production phase, would be reclassified as a component of the asset to which the stripping activity relates. Such balances would then be depreciated or amortised over the expected useful life of the specific section of the ore body to which each stripping campaign component relates. If there is no identifiable section of the ore body to which that component can be directly associated, it would be recognised in profit or loss at the beginning of the earliest period presented. Any existing stripping cost liability balances would be recognised in profit or loss at the beginning of the earliest period presented.


Amendments to IFRS 1

First-time Adoption of International Financial Reporting Standards

First-time adopters of IFRSs would adopt the transitional provisions set out in the new IFRIC, based on the later of the effective date of the final interpretation and the date of transition to IFRSs.

Comment period

The Committee has requested the submission of comments on its proposals by 30 November 2010.



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