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Project **IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine***

Topic **Cover note**

Purpose of this paper

1. The purpose of this paper is to ask the Board to ratify an Interpretation on accounting for stripping costs in the production phase of a surface mine. The IFRS Interpretations Committee ('the Committee') voted on and confirmed the Consensus[1] in the Interpretation in its July 2011 meeting, subject to its final review of drafting changes.
2. The following agenda papers are provided:
   a. This paper 5, which is the cover note paper; and
   b. Paper 5A—IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine* (near final draft).
3. This paper includes the following:
   a. background information on the Interpretation – why it was developed and the due process steps that have been followed;
   b. a summary of the scope of the Interpretation;

[1] With the exception of one member

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

c. an overview of the Consensus reached by the Committee, including a summary explanation of any differences between the Draft Interpretation and the near final Interpretation;

d. the recommended effective date of the Interpretation and the transition guidance given, including a summary explanation of any differences between the Draft Interpretation and the near final Interpretation;

e. details of the Committee's decision not to re-expose the Interpretation;

f. details of one Committee member's disagreement with the Consensus; and.

g. the Committee's recommendation for an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Background information

4. In July 2009 the Committee received a request to issue guidance on accounting for the waste removal (stripping) costs when incurred in the production phase of a surface mine. Such costs may benefit production in the current period or in a future period, and there was no specific guidance in IFRSs addressing the issue. As a consequence of the lack of guidance, there was diversity in practice among entities applying IFRSs—some entities recognised production stripping costs as an expense (a cost of production), and some entities capitalised some or all production stripping costs, on the basis of a 'life-of-mine ratio' calculation, or on some similar basis and some capitalised the costs associated with specific betterments. The Committee decided to develop an Interpretation in response to that diversity in practice and took the issue onto its agenda in November 2009.

5. A Draft Interpretation *Stripping Costs in the Production Phase of a Surface Mine* (DI/2010/1) was published for public comment in August 2010. Fifty comment letters were received. The Committee re-deliberated the issues raised in the comment letters at its January, March and May 2011 meetings. At its July 2011 meeting, the

Committee voted on and confirmed the Consensus. The near-final draft of IFRIC 20 was published to the subscriber section of the website on 10 August 2011.

Scope

6. The scope includes surface mining activities and excludes underground mining activities. The Committee decided not to address oil and natural gas extraction, including the question of whether oil sands extraction was a surface mining activity, when it determined the scope of the Interpretation. The scope also excludes stripping costs incurred during the development phase of the mine, because the Committee became aware that there is no significant diversity in practice in accounting for such costs.
7. The scope remains unchanged from that in the Draft Interpretation.

An overview of the Consensus

Recognition of production stripping costs as an asset

8. The near final draft states that an entity may create two benefits by undertaking stripping activity:
   a. the extraction of ore in the current period (thereby creating an inventory asset) and
   b. improved access to ore in a future period (thereby creating a non-current asset—described in the Interpretation as the 'stripping activity asset'[2]).
9. The inventory asset is to be accounted for under the principles in IAS 2 *Inventories*. The stripping activity asset needs to meet the asset recognition criteria in the *Conceptual Framework for Financial Reporting* to qualify for recognition, as well as an additional criterion required by the Interpretation. This additional criterion

[2] Renamed from 'stripping cost component' used in the Draft Interpretation

requires the entity to be able to identify the component[3] of the ore body for which the access has been improved.

10. This additional criterion was inserted because the stripping campaign concept was no longer being included in the near final Interpretation (see discussion below on the comparison to the Draft Interpretation).

11. The stripping activity asset is accounted for as a part of an existing asset, 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, and will follow the tangible or intangible classification of that existing asset.

Comparison to the Draft Interpretation

12. The Draft Interpretation proposed to require the entity to apply the asset recognition criteria to the costs incurred as part of a stripping campaign. The purpose of this was to determine whether there was a future access asset to recognise, and to be able to circumscribe the stripping costs that would qualify for recognition. However, the concept of a stripping campaign was broadly unsupported by respondents, who noted that the concept was vague, subjective and unnecessarily complex for practical application.

13. Taking the comments into consideration, the Committee re-deliberated the recognition of the asset and how the entity would identify the stripping costs that might qualify for asset recognition, in the absence of the stripping campaign concept. The Committee decided to revert to the existing principles in IAS 16 *Property, Plant and Equipment* for component accounting (paragraph 43 of IAS 16). By identifying a specific component of the ore for which future access was improved by the stripping activity, the entity would be able to identify the stripping costs to be considered for asset recognition.

[3] 'Component' refers to the specific volume of the ore body for which future access is improved by the stripping activity

14. From the outreach that was performed, the Committee understood that it would be practically possible for an entity to identify a component of the ore, and that this information was routinely available for most mining operations.

Initial measurement of the stripping activity asset

15. The stripping activity asset is to be measured initially at cost, being the accumulation of costs incurred while undertaking stripping activity that benefits the identified component of the ore body, plus an allocation of directly attributable overhead costs. This is the same as in the Draft Interpretation.

16. The near final Interpretation takes the initial measurement principle further than was stated in the Draft Interpretation (see the discussion below on the comparison to the Draft Interpretation). The near final Interpretation requires that, if the entity cannot separately identify the costs of the stripping activity asset and the inventory (which we are told is difficult to do directly in practice), then the entity must use an allocation approach based on a relevant production measure[4].

17. The Committee preferred this approach to one based on sales values. The Committee considered that such a basis would be inappropriate because it was not closely linked to the activity taking place. In addition, the Committee understood that applying such a basis would involve practical difficulties and that it would be costly in comparison to the benefit that it would provide. A production measure was considered to be a good indicator of the nature of the benefits that are generated for the activity taking place in the mine, as opposed to the market price of the ore that is to be extracted. Use of this measure should act as a trigger for the entity to consider asset recognition, because it will identify when a level of activity has taken place beyond what would otherwise be expected for the inventory production in the period, and that therefore may have given rise to a future access benefit.

[4] Note the section on one member's disagreement with the Consensus in paragraph 29 of this paper

Comparison to the Draft Interpretation

18. The concept of the stripping campaign in the Draft Interpretation was thought to be sufficient for an entity to be able to identify which costs would be eligible for recognition. The stripping campaign concept was based on the premise that all stripping activity (and the associated costs incurred as a result of this activity) that was taking place as part of the stripping campaign would generate a future benefit—that is, improved access to a section of the ore body which would only be mined in the future. Without the concept of the stripping campaign, an alternative basis was needed to identify the stripping costs that might qualify for asset recognition.

19. The Committee therefore decided to use the concept of identification of the *component* of the ore body for which access had been improved, as part of the criteria for recognising stripping costs as an asset (paragraph 8). This component approach follows the principle of separating out parts of an asset that have costs that are significant in relation to the entire asset in IAS 16 *Property, Plant and Equipment* (paragraph 43 of IAS 16) and when the useful lives of those parts are different. The Committee thought that reverting to the existing principles in IAS 16 would avoid introducing the stripping campaign approach that respondents had thought would be onerous to identify and make operational. The component approach would still provide a link between the stripping costs incurred and the section (or subset) of the total ore body for which access was improved. This is also important for the subsequent depreciation or amortisation of the stripping activity asset.

Subsequent measurement of the stripping activity asset

20. The Interpretation requires that the stripping activity asset is carried at cost or revalued amount less depreciation or amortisation and impairment losses, in the same way as the asset of which it is part.

21. The stripping activity asset will be depreciated over the component of the ore body that becomes more accessible as a result of the stripping activity.

Comparison to the Draft Interpretation

22. First, in the near final Interpretation, the Committee decided that the principles would also be applicable to an entity that subsequently accounts for its mine assets at revaluation, although the Committee noted that this method was seldom used.

23. Secondly, the Committee decided to no longer refer to impairment within the Consensus of the near final Interpretation, because the Committee expects that the requirements of IAS 36 *Impairment of Assets* should apply to impairment of stripping activity assets, and it was concerned that if impairment was addressed in the Consensus, constituents might think that something different was required. This is explained in the Basis for Conclusions.

Effective date and transition

24. The near final Interpretation requires prospective application of the principles—this is the same as in the Draft Interpretation. It also requires that existing stripping activity asset balances at transition date, and for which there is no identifiable component of the ore body with which to associate them, should be recognised in opening retained earnings.

Comparison to the Draft Interpretation

25. The Draft Interpretation required that existing stripping activity asset balances at transition date, and for which there is no identifiable component of the ore body with which to associate them, should be recognised in profit or loss at the beginning of the earliest period presented. This was changed to recognition in opening retained earnings as a result of the suggestions received in the comment letters, and to align the transition provisions with the principles in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

26. The Draft Interpretation also included guidance on recognition of any existing stripping activity liability balances at transition date. A number of commentators were confused by this reference, because they said that such balances were

uncommon, or else that they had never come across such liability balances in practice. Our outreach supported this view and we have removed such guidance from the Consensus of the near final Interpretation and included it in the Basis for Conclusions.

Proposed effective date

27. The Committee recommends that the effective date for the Interpretation is annual periods beginning on or after 1 January 2013 (with earlier application permitted, per paragraph A1 of the near final Interpretation). If the Interpretation is issued before 1 January 2012, the Committee thinks that this should provide entities with sufficient time to prepare comparative figures as required by paragraph A2 of the near-final Interpretation

The issue of re-exposure of the near final Interpretation

28. At its July 2011 meeting, the Committee concluded that the changes made to the Draft Interpretation in developing the near final Interpretation reflect the constituents' views, specifically about the stripping campaign concept and the transition provisions. The Committee decided that re-exposure was not necessary, because there were no significant changes in principle between the Draft Interpretation and the near final Interpretation.

One member's disagreement with the Consensus

29. At its July 2011 meeting, the Committee was asked to vote to confirm the Consensus of the near final Interpretation. All the members except for one, Joanna Perry, agreed to confirm the Consensus. Ms Perry's objection was based on the fact that she believes that it is inappropriate under principle-based standards (and interpretations) to specify an exact method of allocation of costs between inventory and a stripping activity asset, referring to paragraph 13 of the near final Interpretation, under Initial Measurement of the Stripping Activity Asset.

Amendment to IFRS 1

30. The Committee recommends that the Board should approve an amendment to IFRS 1 (refer Appendix B of agenda paper 5A for details of the amendment), as part of its approval of the Interpretation.

Questions for the Board

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Does the Board agree to ratify the near final Interpretation, IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*? Does the Board agree with the proposed effective date for the interpretation of annual periods beginning on or after 1 January 2013?