

Extracting value



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Focussing on resources industry issues

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Welcome to Issue 9 of *Extracting value*, an edition focussing on the Draft IFRIC Interpretation DI/2010/1 *Stripping Costs in the Production Phase of a Surface Mine*, recently released by the International Accounting Standards Board (IASB)

On 26 August 2010, the IASB issued Draft IFRIC Interpretation DI/2010/1 'Stripping Costs in the Production Phase of a Surface Mine', with the intention of eliminating diversity in practice that exists around the globe. The draft interpretation focuses on stripping costs incurred in surface mining activity (e.g. strip mining and open pit mining) as it is believed this is predominantly where such activity takes place. The draft interpretation addresses whether the definition of an asset is met, when the stripping component should be recognised and how the stripping campaign costs should be recognised at initial recognition and subsequently.

Stripping, the process of removing mine waste material (overburden) to gain access to mineral ore deposits, can occur in each phase of a mine. During the development phase it is generally accepted that stripping costs are an asset that can be capitalised. The main area of divergence however is the accounting for stripping costs in the production phase.



The table below is an overview summary of some of the accounting approaches currently used to account for stripping costs:

Method	Approach	Comments
Expense	All stripping costs incurred during the production phase of a mine are expensed as incurred	Introduces significant volatility in profit or loss if the mine plan has periods where proportionately more or less waste material is removed. Accordingly, this approach is commonly adopted where large scale stripping does not occur in advance of related production.
Inventory cost	Stripping costs are treated as a variable period inventory cost	This is the prescribed approach in the United States and can result in significant volatility in reported profits from year to year as mine plans change – ore produced in years of greater stripping activities will have a higher cost of production.
Capitalise if a 'betterment' to the mining asset	Stripping costs are capitalised if they result in a 'betterment' of the mining asset, otherwise treated as a variable period inventory cost	This is the prescribed approach under Canadian GAAP. Costs related to future production are capitalised if they relate to future reserves, and amortised over those future reserves.
Stripping ratio	Stripping costs are allocated to all production on the basis of the ratio of waste material to ore	This generally results in an 'averaging' of the cost of waste removal over all the reserves. Variants of the model may anticipate future waste removal costs or applying different stripping ratios to parts of the overall mining operation.

The draft interpretation proposes that the costs of stripping activity that are part of a 'stripping campaign' be accounted for as an addition to, or enhancement of, an existing asset as they create a benefit in terms of improved access to the ore to be mined. The stripping campaign component of an asset should initially be measured at cost at the time the stripping activity takes place and the costs of creating the stripping campaign are incurred. Routine stripping costs that are not incurred as part of a stripping campaign would be accounted for as a cost of production.

The key to this accounting is differentiating between a stripping campaign and routine stripping. A stripping campaign would be defined 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.

Subsequent to initial recognition the stripping component of the asset to which it is related shall be depreciated or amortised in a rational and systematic manner, over the specific section of the ore body that becomes directly accessible as a result of the stripping campaign, subject to impairment.

Issues for consideration

In applying the proposals two significant judgements will be required to be made by preparers of financial statements. In contemplating these issues, consideration should also be given to the modifications that may become necessary to existing systems in order to track separately the stripping costs between the various ore bodies accessed.

Firstly, entities will need to clearly define their production phase, there is currently no definition of the production phase, The IASB Discussion Paper DP/2010/1 *Extractive Activities* defines production as involving '... the extraction of natural resources from the earth and the related processes necessary to make the produced resource marketable or transportable', whereas the Staff Paper put to the IFRIC meeting in November 2009 defined production as 'when saleable product is obtained from the mineral reserve'. Such uncertainty around the definition can be complicated by the fact that there may often be circumstances where development activities are continuing during production and determining the cut off between the two will require judgement.

Secondly, entities will need to distinguish between stripping campaigns and routine stripping costs. Stripping campaign costs will be capitalised and depreciated or amortised in relation to the section of ore that becomes directly accessible as a result of the stripping activity versus routine stripping costs that will be accounted for as a cost of production. As such it may be necessary to split:

- Stripping costs across the different ore bodies being accessed as a result of the stripping activity. This however would not allow costs to be split between an ore body that becomes directly accessible as a result of the stripping campaign and an ore body that will only become accessible after the directly accessible ore body has already been removed
- Current period costs between routine stripping and stripping campaigns. The draft interpretation believes distinguishing such costs should be possible as it is understood that entities plan for stripping campaigns well in advance and that such campaigns are typically well enough defined by an entity's mine plan to determine the split.

For those entities which have included stripping costs in the cost of inventory rather than using a stripping ratio or similar approach, the proposals will also require systems modifications to permit depreciation or amortisation calculations to be made, with the related judgements required in determining the useful life of an ore body.



Where to from here?

The draft interpretation does not include a proposed effective date however on initial prospective application it is proposed that existing stripping cost assets resulting from stripping activity undertaken during the production phase would need to be allocated to the stripping activity to which it relates, and then depreciated or amortised over the expected useful life of the ore body to which each stripping campaign component relates.

The draft interpretation is open for comment under 30 November 2010. We encourage all companies undertaking surface mining to respond to the proposals but also for other companies to consider commenting where they might want to analogue the draft interpretation for costs incurred in other forms of extractive activities.

As a result of these proposed provisions, and in particular due to the widespread application of the stripping ratio approach currently in Australia, it may be common that an expense will need to be recognised in profit and loss at the beginning of the earliest period presented on adoption of a finalised interpretation, in order to write-off stripping campaign costs that relate to ore bodies that are already fully mined. This assumes that entities are able to allocate past stripping costs to specific ore bodies. To the extent an entity is not able to allocate such costs they may be required to be expensed at transition. This may warrant entities to consider their current systems more closely now before any Interpretation is issued.



Contacts

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