

Issues Paper – Draft IFRIC Interpretation DI/2010/1
Stripping Costs in the Production Phase of a Surface Mine

1. This paper addresses issues identified by AASB staff in IASB DI/2010/1 *Stripping Costs in the Production Phase of a Surface Mine*. It includes:
 - (A) background to DI/2010/1;
 - (B) AASB staff analysis addressing key issues identified in DI/2010/1; and
 - (C) other AASB staff concerns.

(A) Background

2. There is currently no specific guidance in IFRSs addressing accounting for ‘production stripping costs’ (i.e. costs of removing waste to gain access to mineral ore deposits in the production phase), which has resulted in diversity in how entities account for such costs in practice. Some entities capitalise ‘production stripping costs’, on the basis of a life-of-mine ratio calculation, or some similar basis; some entities expense all production stripping costs as a cost of production (US GAAP approach); and some capitalise the costs associated with specific betterments (Canadian GAAP approach). Due to the diversity in international practice of accounting for ‘production stripping costs’, the IFRS Interpretations Committee received a request to issue guidance on this issue and as a result the IASB published DI/2010/1.
3. DI/2010/1 proposes that:
 - (a) the costs of stripping activities that are part of a ‘stripping campaign’ (i.e. systematic efforts to gain access to a specific section of the ore body) shall be accounted for as an addition to, or an enhancement of, an existing asset. Accordingly, the costs incurred will be accounted for as a component of an existing asset;
 - (b) the ‘stripping campaign component’ shall be recognised initially at cost, being the accumulation of costs directly incurred to perform the stripping activity and an allocation of directly attributable costs. It shall be depreciated or amortised over the expected useful life of the section of ore that becomes directly accessible as a result of the stripping campaign (i.e. specific identification approach). The units

- of production method shall be applied, unless another method is more appropriate;
- (c) the 'stripping campaign component' shall be subject to impairment testing in accordance with IAS 36 *Impairment of Assets*;
 - (d) routine stripping costs, which are not incurred as part of a 'stripping campaign', shall be accounted for as a production cost in accordance with IAS 2 *Inventories*; and
 - (e) on transition, any existing asset balance related to production stripping shall be reclassified as a component of the larger asset to which it relates. Any existing stripping campaign component of an asset that cannot be directly associated with an identifiable section of the ore body and any existing stripping cost liability balances shall be recognised in profit or loss at the beginning of the earliest period presented.

(B) Staff Analysis of Key Issues

4. In concept, the 'specific identification approach' for the accounting of 'production stripping costs' is appropriate and consistent with the accounting principles in IFRSs, however AASB staff are concerned that DI/2010/1 is not addressing the request for guidance on how to account for waste removal costs in the production phase of a mine. Instead, DI/2010/1 proposes a new interpretation of how to account for 'production stripping costs', which is different from the way we understand these costs are currently accounted for in practice. We note that constituents are concerned that the proposals may not be practicable.
5. We understand that there is current divergence in practice in accounting for 'production stripping costs' between Canadian GAAP, US GAAP and IFRS reporters, however the differences between Canadian GAAP, US GAAP and IFRS reporting are not relevant to an IFRIC interpretation. Within the context of IFRSs, constituents do not consider there to be significant divergence in practice. Currently, in practice, many entities that apply IFRSs apply a life-of-mine ratio approach to all stripping costs incurred to determine which stripping costs are expensed and which costs are deferred and depreciated/amortised in future periods. This approach considers the mine as a whole rather than components of mineral ore that become accessible. Under this approach an

average or life-of-mine strip ratio [volume of overburden (m³) / weight of ore (tonnes)] is calculated when the mine plan is compiled. In each subsequent period the entity will compare this life-of-mine strip ratio to the actual strip ratio in a period (calculated using the same formula as the average strip ratio). To the extent that the actual strip ratio is greater than the average strip ratio, waste removal costs would be capitalised. In the opposite scenario, when the actual strip ratio is lower than the average strip ratio, waste removal costs would be expensed. We understand from our constituents that this approach is commonly used in practice and is well understood by preparers and users of financial statements.

6. DI/2010/1 would require entities to:
 - (a) allocate the stripping costs of each stripping campaign, incurred in the production phase, to the mineral ore that becomes accessible (specific identification approach); and
 - (b) apply a different accounting treatment to waste removal costs incurred as part of a stripping campaign (in the production phase) to those that are part of routine activities in the production phase and to those incurred in the pre-production phase.

(a) Specific identification approach

7. DI/2010/1 proposes to disaggregate an asset (the whole mine) into specific sections of ore body in order to account for production stripping costs. IAS 16 *Property, Plant and Equipment* includes a principle for component accounting, which requires significant parts of an asset to be depreciated as a separate component of the asset because the useful life or the depreciation method may be different to other parts of the same asset. We support the concept of applying component accounting principles to production stripping costs. However, we are concerned that the application of the DI/2010/1 proposals would be difficult for many mining entities to apply in practice, especially in complex scenarios, such as multi-pit mining operations, where the entire asset is not fully identifiable and the full extent of the asset cannot be reliably determined or where stripping effectively occurs continuously.
8. In accordance with IAS 16, the airframe and the engines of an aircraft are accounted for as two separate parts of one asset. These two components are easily identifiable and

distinguishable and therefore can be treated as two separate components of an asset for depreciation purposes. However there may be practical challenges in applying this to mining operations where the mine, as a whole, cannot be reliably separated into identifiable components. In many cases the section of the ore body that is planned to be extracted may change as a result of operational circumstances. For example, additional ore bodies may be identified that were not part of the mine plan or it may be later determined that a section of ore may not be of a high quality and therefore not feasible to extract. These circumstances will only be determined once the stripping activities are in progress and access to the ore body is obtained, which will impact the allocation of stripping costs to particular sections of ore body that become directly accessible as a result of the stripping campaign. Therefore constituents are concerned that componentising one large body of ore that is not fully identifiable is not a practicable interpretation of the accounting principles and is unlikely to resolve the diversity that is currently found in practice. Furthermore, constituents do not consider the attribution of stripping costs to separately identifiable sections of ore to be a relevant or reliable depiction of how most mines operate.

(b) Varying accounting treatment for waste removal costs

9. The proposals in DI/2010/1 suggest that there would be three different ways of accounting for waste removal costs. These are:
 - (a) pre-production stripping costs, which are currently capitalised in practice as part of the development phase and depreciated/amortised over the life of the mine (not addressed in DI/2010/1);
 - (b) routine stripping costs, which would be required to be expensed as part of production costs; and
 - (c) production stripping costs, which would be capitalised as a stripping campaign component and depreciated/amortised over the expected useful life of the specific section of ore body that becomes directly accessible as a result of the stripping campaign.
10. DI/2010/1 proposes an accounting treatment for stripping costs in the production phase that is different from the way in which entities currently account for stripping costs in the production phase and the development phase. ‘Development phase’ and ‘production phase’ are not defined in IFRSs, and therefore these terms are currently

interpreted in different ways. Proposing an interpretation that is only applicable to the production phase may create further diversity, because some entities might account for certain waste removal costs in the development phase whilst others might account for the same costs as part of the production phase, resulting in two different accounting results.

11. It is not clear why the accounting for production stripping costs should be different from the accounting for pre-production stripping costs. We think that the accounting for stripping costs, irrespective of whether incurred in the development phase or in the production phase, should be done in a consistent manner. Because DI/2010/1 only addresses the ‘production phase’, there is a likelihood it may result in stripping costs being accounted for differently in the development phase and production phase and therefore we question whether the scope of DI/2010/1 is too narrow.
12. Furthermore, AASB staff are concerned that the reference to terms such as ‘systematic process’ and ‘more aggressive process’ in paragraph 4 of DI/2010/1 and, ‘incidental operations’ in paragraph 15 in DI/2010/1 do not clearly define ‘stripping campaign’ and therefore there are likely to be different interpretations of what gets expensed as routine costs and what gets capitalised as a stripping campaign component. Paragraph BC13 says that routine stripping costs should not be recognised as part of an asset even if the routine stripping creates a benefit that will be realised in a future period. This is inconsistent with the asset recognition criteria in IFRSs that require an asset to be recognised if future economic benefits associated with the item will flow to or from the entity and the cost can be measured reliably.
13. Based on the above staff analysis, we think the IFRS Interpretations Committee should reconsider the proposals in DI/2010/1, and instead respond directly to the request it received and only provide guidance on accounting for production stripping costs rather than establishing a new interpretation of how to account for production stripping costs to the way these costs are currently accounted for in practice. AASB staff think the guidance should support the principles already within IFRSs, in particular the asset recognition criteria. The asset recognition criteria in paragraph 7 of AASB 116 say:
“the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
- (b) the cost of the item can be measured reliably.”

14. AASB staff think that the interpretation of current principles for the accounting of waste removal costs should be:

Waste removal (stripping) costs incurred shall be recognised as an asset only when it is probable they will result in an inflow of future economic benefits to the entity that can be measured reliably. The capitalised costs shall be depreciated or amortised in a rational and systematic manner, over the expected useful life of the asset to which the costs relate. The depreciation or amortisation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.

15. Questions for the Board

- (a) Does the Board agree that DI/2010/1 establishes a new interpretation to the way entities currently apply the principles of IFRSs in practice?
- (b) Does the Board agree that the IFRS Interpretations Committee should reconsider the proposals in DI/2010/1?
- (c) Does the Board agree with the AASB staffs’ proposed interpretation of current principles in IFRSs, for the accounting of all waste removal costs?

(C) Other concerns

16. If the IFRS Interpretations Committee proceeds with the proposals in DI/2010/1, AASB staff think the following additional concerns should be addressed:

- (a) appropriateness of the transitional requirements;
- (b) usefulness of the illustrative examples;
- (c) depreciation/amortisation method;
- (d) consistency of the proposals with IAS 136 *Impairment of Assets*; and
- (e) disclosures.

(a) Appropriateness of the transitional requirements

17. Constituents do not agree with the proposed transitional provisions for existing stripping costs balances. They think entities should not be required to recognise stripping campaign components that cannot be directly associated with an identifiable section of ore body and any stripping cost liability balances in profit or loss at the beginning of the earliest period presented. Constituents are concerned that this is likely to result in many mining entities recognising significant profit or loss adjustments at the beginning of the earliest period presented, which may cause significant volatility in the financial statements.

Consistent with our constituents' views, AASB staff think that the transitional adjustments should be recorded through retained earnings. However, AASB staff interpret the phrase 'recognised in profit or loss at the beginning of the earliest period presented' to require entities to record the transitional adjustments through retained earnings rather than through profit or loss. Because the wording of the transitional requirements has been interpreted differently by constituents and AASB staff, we suggest that the wording be amended to clarify how the transitional adjustments should be accounted for.

18. Question for the Board

Does the Board agree that the transitional adjustments should be adjusted through retained earnings and the wording of the transitional requirements amended to make this clear?

(b) Usefulness of illustrative examples

19. AASB staff are concerned that the illustrative example provided in DI/2010/1 does not consider the complexities that many mining operations deal with and therefore it is not likely to be useful to mining entities that apply DI/2010/1. If the IFRS Interpretations Committee proceeds with DI/2010/1, the AASB staff think that DI/2010/1 should include more comprehensive examples that may assist mining entities in applying the principles in more complex environments than a single pit mine.

20. Question for the Board

Does the Board agree that more comprehensive examples should be included as part of the guidance in DI/2010/1?

(c) Depreciation/Amortisation method

21. AASB staff agree that the unit of production method is an appropriate method for depreciating or amortising capitalised stripping costs. However, we are concerned that the wording in paragraph 17 of DI/2010/1, that specifically requires the unit of production method to be applied unless another method is more appropriate, is too rules-based. The proposed wording is not consistent with IAS 16 or IAS 38 *Intangible Assets*, which provide a high level principle that requires a depreciation or amortisation method to be selected that reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. This requires entities to choose an appropriate depreciation or amortisation method without placing immediate emphasis on any particular method. Without placing undue emphasis on the straight line method, IAS 38 requires the straight-line method to be applied if another method does not reliably reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
22. We think the wording of paragraph 60 of IAS 16 more appropriately describes a principle that requires a choice of depreciation or amortisation methods that shall be applied.

23. Question for the Board

Does the Board agree that the wording of DI/2010/1 places too much emphasis on the unit of production method and should be amended to be more consistent with the principles in IAS 16 and IAS 38?

(d) Consistency of the proposals with IAS 36 *Impairment of Assets*

24. Paragraph 19 of DI/2010/1 says "an entity should consider the stripping campaign component for impairment in accordance with IAS 36". Constituents are concerned that this suggests that impairment principles should be applied at a component level,

which is inconsistent with the principles in IAS 36, which require an asset or a cash-generating unit to be tested for impairment rather than a component of an asset.

25. AASB staff do not consider this to be an issue. Although DI/2010/1 explicitly requires the stripping campaign component to be considered for impairment in accordance with IAS 36, we do not think that this means that impairment needs to be considered at a component level. Instead, we think that if there is an indication that a stripping campaign component is impaired, the principles in IAS 36 would require the asset or cash generating unit to which the component relates to be tested for impairment.

26. Question for the Board

Does the Board agree with AASB staff that the principles in IAS 36 would require the asset or cash generating unit to which the component relates to be tested for impairment, rather than the component itself?

(e) Disclosures

27. Constituents have raised concerns that the proposals suggest that the disclosure requirements shall be applied to each stripping campaign component (i.e. at a component level) rather than at a class level, which is currently required in IAS 16 and IAS 38.
28. AASB staff do not think that this is an issue. DI/2010/1 does not include any additional disclosure requirements and therefore the disclosures in IAS 16 or IAS 38 shall apply to the stripping campaign component. The disclosure requirements in IAS 16 and IAS 38 specifically require disclosure at a class level and therefore, for disclosure purposes, the stripping campaign component would be included in the class of assets to which it relates.

29. Question for the Board

Does the Board agree with AASB staff that IAS 16 and IAS 38 would require disclosure relating to a stripping campaign component at a class level rather than a component level?