Project **Extractive Activities**

Topic **Accounting for stripping costs in the production phase – definition of scope**

Objective of this paper

1. In June 2009 a request was received for guidance in respect of the accounting treatment of stripping costs during the production stage of the mine. At the IFRIC meeting in November 2009[1], the IFRIC agreed to take the issue onto the agenda.

2. The objective of this paper is to define the scope of the production stripping costs issue. The staff is undertaking ongoing outreach to various mining groups around the world in respect of the stripping cost issue. Responses to date are included in Appendix A, and have been taken into account in developing the scope concept.

The scope concept

3. The staff have provisionally described a general concept of the issue, from which the scope of the interpretation will be derived. The general scope concept is as follows:

Accounting for the costs of removal of uneconomic overlying material in a surface mine during the production phase, in order to access an economically valuable mineral reserve.

4. The staff see the main themes of the scope concept as follows:

    1. To include all extractive activities, or only the extraction of minerals (paragraphs 5 - 7)

    2. To have an industry focus or an activity focus (paragraph 8 - 9);

[1] The papers discussed at the November 2009 IFRIC meeting were paper 2A *Preliminary Discussion – accounting for stripping costs in the production phase*, and paper 2B *Tentative agenda decision – Accounting for stripping costs in the production phase*

3. To include all stages of mining, or only the production stage (paragraphs 1011 - 11)

4. To focus only on surface mining, or to include all types of mining (paragraphs 12 - 13).

Discussion

All extractive activities or only extraction of minerals?

5. The staff considered whether to include all extractive activities in the scope of the issue. According to the working draft of the discussion paper (DP) *Extractive Activities*[2] extractive activities are all those associated with exploring for and finding minerals, oil and natural gas deposits, developing those deposits and extracting the minerals, oil and gas (also known as upstream activities).

6. The staff proposes that the scope of the stripping costs interpretation be more narrowly defined than to include all extractive activities. The staff propose only to include the extraction of minerals in the scope, and not to extend the scope to include oil and gas extraction. The *Extractive Activities* DP states that 'Minerals are naturally occurring materials in or on the earth's crust that include metallic ores (such as copper, gold, silver, iron, nickel, lead and zinc), other industrial minerals (non-metallic minerals, aggregates), gemstones, uranium and fossilised organic material (coal).' The staff understand that the stripping technique is most commonly used in surface mining activity - oil and gas deposits are typically extracted using other methods.

7. However, the staff have noted through the outreach process that extraction of oil deposits in sands/shale can involve a process similar to stripping. The implication is that entities mining oil in this way may apply, by analogy, guidance issued by the IFRIC on accounting for stripping costs. The staff think that this would be acceptable.

Question 1 for the IFRIC

[2] Hyperlink to the working draft of the discussion paper *Extractive Activities:* *http://www.iasb.org/NR/rdonlyres/C36EDD84-0D4E-41F5-94B6-A2D5A12B75AF/0/ExtractivesDPworkingdraft10August2009.pdf*,

Does the IFRIC agree with confining the scope of the interpretation to extraction of minerals?

Industry or activity focused?

8. The staff considered whether to confine the scope of the stripping costs issue to the mining industry. Through feedback received during the outreach process, the staff decided that it may be preferable to focus on the activity of overburden removal, rather than on the mining industry. The word 'mining' is most commonly used as a verb, to describe the physical activity of extracting minerals from the earth. 'The mining industry' is usually considered in practice to include *all* mining related activities (including exploration and evaluation), and the staff think this would conflict with the objective stated in paragraphs 5 - 7 above.

9. At this stage, the scope concept does not include any of the phrases 'stripping costs', 'production stripping' or 'advance stripping'. These are labels currently used in the mining industry for the activity of removing the uneconomic overlying material, or overburden.

Question 2 for the IFRIC
Does the IFRIC agree that the scope should refer to the activity of overburden removal, or does the IFRIC think the it should be more specific, e.g. to refer to 'stripping activity in the mining industry'?

Confine to the production phase?

10. The staff considered whether or not the scope should be confined to the production phase of the life cycle of a mine[3]. It then became clear during the outreach process that this would be preferable: respondents confirmed that costs incurred in the development phase are already capitalised in practice as a general rule, as part of the depreciable cost of building, developing and constructing the mine. IAS 16 *Property, Plant and Equipment* paragraph 16(b) supports this treatment: it states that an entity may capitalise any costs that are directly attributable to bringing the

[3] Most mines have a life cycle of 5 phases – exploration, evaluation, development (and construction), production and closure.

asset to the location and condition necessary to operate as management has intended. IFRS 6 *Exploration for and Evaluation of Mineral Resources* provides guidance for activity in the exploration and evaluation stages of the mine's life cycle.

11. Some feedback suggested that if the scope of the interpretation is confined to the production phase, that it be accompanied by a definition of the production phase, since the line between where development ends and production begins can be grey in practice. This definition may include wording such as *'the production phase of the mine commences when saleable minerals are extracted (produced), regardless of the level of production or revenue'*. One constituent has also suggested the use of a concept similar to that in IAS 16 *Property, Plant and Equipment*, where the mine has entered production when it is in the *'condition necessary for it to be capable of operating in the manner intended by management'*.

Question 3 for the IFRIC
Does the IFRIC agree that the scope should be confined to the production phase of the life cycle of a mine?

Focus on surface mining?

12. Outreach feedback supported confining the scope of the issue to surface mining operations. This would therefore exclude underground mining operations from the scope. Surface mining is a type of mining where soil and rock overlying the mineral deposit are removed, and is different from underground mining, where the overlying rock is left in place and the mineral is removed through shafts or tunnels. Surface mining is done when deposits of the ore are found near the surface, and the layer of overburden is relatively thin.

13. The staff is aware some entities may apply the guidance developed by analogy to certain costs in underground mining operations, e.g. constructing a new shaft in an underground mine in order to access ore in future periods, after production has commenced. The staff think that this would be acceptable.

Question 4 for the IFRIC

> Does the IFRIC agree that the scope should be confined to surface mining operations?

Terminology

14. At this stage, the staff think that some terms may need to be defined in the interpretation, to avoid ambiguity and misapplication of the guidance. The terms thus far identified would be:
    1. The production phase;
    2. Production stripping;
    3. Surface mining.

The future benefit created

15. The IFRIC Update for the November 2009 meeting stated:

    'In their discussions, the IFRIC noted that, in general, mine development costs qualify for capitalisation. Further, the IFRIC noted that, in principle, where production stripping activities create a future benefit for the entity, the related costs would qualify for recognition of, or as part of the carrying amount of, an asset'.

16. The staff will present a paper at the March 2010 IFRIC meeting further debating the potential future benefit created by production stripping activity. However, for the purposes of defining the scope of the issue, the staff are considering whether the creation of a future economic benefit should form part of the scope. That is, should the scope be restricted to only circumstances where overburden removal activity results in a future economic benefit being created.
17. The staff is concerned that, by limiting the scope of the issue to the overburden removal activity that creates a future benefit only, the discussion around how to account for the remainder of the overburden removal costs incurred during the production phase (that do not create a future benefit) may be lost. The staff recognises that at least some overburden removal costs incurred during the production phase may be current period costs, in line with the published literature of both the US and Canadian standard setters. If the scope is not limited to circumstances where a future benefit is created, then we expect to include asset recognition criteria in the interpretation to assess whether a future economic benefit

should be recognised. The staff therefore propose the scope concept as articulated in paragraph 3.

Question 5 for the IFRIC
Does the IFRIC agree with the staff's proposal to not limit the scope to that overburden removal activity that results in a future benefit being created?

Comparison with other GAAP

Canadian GAAP

18. In March 2006, the Canadian Emerging Issues Committee issued EIC-160 S*tripping Costs Incurred in the Production Phase of a Mining Operation.* The Abstract's introduction paragraph (including the scope of the issue) states the following:

> 'In the mining industry, entities may be required to remove overburden and other mine waste materials to access mineral deposits. The costs of removing overburden and waste materials are referred to as "stripping costs". During the development of a mine (before production begins), it is generally accepted in practice that stripping costs are capitalized as part of the depreciable cost of building, developing and constructing the mine. Those capitalized costs are typically amortized over the productive life of the mine using the unit of production method. A mining company may continue to remove overburden and waste materials, and therefore incur stripping costs, during the production phase of the mine'

The Abstract considers the following issues:

1. Should stripping costs incurred in the production phase of a mining operation be capitalized or expensed?
2. If stripping costs are capitalized, how should they be amortized?
3. How should capitalized stripping costs be classified on the cash flow statement?
4. What disclosures should be made about stripping costs?

The consensus was that production stripping costs would fall into one of two buckets: either to be accounted for as variable production costs, or capitalised if the stripping activity is shown to represent a 'betterment'[4] to the mineral property.

US GAAP

[4] A betterment occurs when the stripping activity provides access to sources of reserves that will be produced in future periods that would not have otherwise been accessible in the absence of this activity.

19. The FASB ASC Subtopic 930-330 *Extractive Activities−Mining−Inventory*[5] issued in 2006 stated its scope to include ‘stripping costs incurred in the production phase of the mine’, and included all mining entities other than those producing oil and gas. The consensus reached was that stripping costs incurred in the production phase of a mine are variable production costs that should be included in inventory produced in the period.

Proposed scope for the IFRIC Interpretation

20. The staff think that the scope concept discussed in paragraph 3 of this paper follows similar lines as those in the existing guidance issued by the Canadian and US standard setters:

Accounting for the costs of removal of uneconomic overlying material in a surface mine during the production phase, in order to access an economically valuable mineral reserve.

Question 6 for the IFRIC
Does the IFRIC have any other comments or points that the staff should consider in finalising the scope of the issue?

[5] EITF 04-6 *Accounting for Stripping Costs Incurred during Production in the Mining Industry.*

Appendix A – Outreach on the production stripping costs issue

A1 The staff prepared some basic questions around the scope of the stripping costs issue and asked for feedback from various mining entities and other individuals closely related to the mining industry. The staff consider the outreach process to be ongoing.

A2 Results to date of the outreach on this issue are presented in the table below.

1. Staff questions on the scope of the stripping costs issue	2. Summary of feedback received
1. Should the scope consider *both* minerals and oil and natural gas, *or* only minerals?	• Focus on mineral extraction • Possible application by analogy to mining for oil in oil sands/shale
2. Should we specify the phase of the mine (exploration/evaluation/development/ production) in the scope?	• Confine to production phase; generally accepted that stripping costs are capitalised in the development phase. • Possibly consider providing a definition of when production phase begins • Possibly also consider defining what a mine is: one ore body or a collection of separate pits or 'workings'? This will help clarify the application of the issue to mines with multiple pits
3. Do stripping activities occur in sub-surface mining operations? Should the scope of the issue be limited to only include surface mining operations?	• Confine scope to surface mining activity • 'stripping-like' activities occur in sub-surface (underground) mining; more of the nature of advance development, allowing subsequent mining activity to progress. Consider that there will be possible application by analogy of stripping cost guidance to underground mining.

4. Is 'pre-stripping' the same concept as 'stripping'? Are 'production stripping' and 'advance stripping' the same concept?	• 'Pre-stripping' is the activity prior to production. 'production stripping' and 'advance stripping' relate to activity during the production phase • Suggest limiting to concept of 'production stripping'
5. Would the scope need to differentiate between planned 'normal' stripping and planned 'abnormal' stripping? Would a push-back be an example of planned abnormal stripping?	• Not considered relevant to separate out 'abnormal' stripping; could mean different things to different entities
6. Should the concepts of 'reserve' and 'resource' be considered in the scope of the issue? Stripping is a development activity, therefore is it only undertaken once the mineral *reserve* has been identified?	• Concentrate on mining of reserves; concept of resource not relevant since the production phase will relate to ore reserves already identified
7. Do you think there is enough general development cost guidance in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* that could be applied to the stripping costs issue, or do you think more specific guidance is required?	• Production stripping costs that provide a future benefit are more in the nature of an improvement to the mine asset (like PPE); not dealt with in IAS 16 • More specific/focused guidance is needed on amortisation of any capitalised costs of this nature – IAS 16 does not provide enough specific guidance here
8. Do you think an asset is created when stripping activity benefits a future period? If yes, are there instances in practice where such assets are not recognised for particular reasons?	• Yes, the definition of an asset is met when stripping activities benefit future periods • Immateriality or, more rarely, specific jurisdictional tax issues may be reasons why such assets are not recognised