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Project **Extractive Activities**

Topic **Accounting for stripping costs in the production phase – draft interpretation**

IFRIC [X] ACCOUNTING FOR STRIPPING COSTS IN THE PRODUCTION PHASE

References

Framework

IAS 16 *Property, Plant and Equipment*

IAS 38 *Intangible Assets*

IAS 1 *Presentation of Financial Statements*

Background

1. In surface mining operations, entities may find it necessary to remove mine waste materials (overburden) to gain access to mineral deposits. This waste removal activity is known as 'stripping', and the costs incurred as a result of the activity are known as 'stripping costs'.

2. During the development phase of the mine (before production begins), it is generally accepted in practice that stripping costs are capitalised as part of the depreciable cost of building, developing and constructing the mine. Those capitalised costs are typically depreciated or amortised over the life of the mine using the units of production method, once production begins.

3. A mining entity may continue to remove overburden and to incur stripping costs during the production phase of the mine. Stripping costs in the production phase may be part of the routine costs incurred during production. Production stripping costs may also be incurred as part of a systematic effort to gain access to a specific section of ore. This Interpretation refers to such a concentrated production stripping effort as a 'stripping campaign'.

4. A stripping campaign will typically be planned in advance and form 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 to which the campaign is associated.

Scope

5. This [draft] Interpretation applies to waste removal costs that are incurred in surface mining activity, during the production phase of the mine.

Issue

6. The [draft] Interpretation addresses the following issues:

   (a) Is the definition of an asset met?

   (b) When shall the asset be recognised?

   (c) How shall the asset be initially measured?

   (d) How shall the asset be subsequently measured?

Consensus

Is the definition of an asset met?

7. An entity creates a benefit by undertaking stripping activity (and incurring stripping costs). This benefit is of improved access to the ore to be mined. An entity shall assess whether the benefit meets the definition of an asset set out in the *Framework*. Paragraph 49(a) 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 benefit of improved access to the ore will qualify as an asset when:

(a) An entity controls the benefit created by the stripping activity, by either owning the land which it is mining, or owning the rights to mine the land;

(b) The benefit arises as a result of stripping activity, therefore 'as a result of past events', and

(c) A future economic benefit will flow to an entity through access to reserves that are expected to be economically recoverable in the future.

8. Where the benefit does not meet the definition of an asset, the related stripping costs shall be included as operating costs in the current reporting period.

9. Where the benefit does meet the definition of an asset, and the stripping activity benefits the current reporting period only, then the stripping costs are a component of the cost of inventory produced in the current reporting period and shall be accounted for in accordance with IAS 2 *Inventories*. This would be the case, for example, where stripping activity is routinely undertaken to access ore which is expected to be mined in the current reporting period.

10. Where stripping activity benefits a future reporting period, as would be the case under a stripping campaign, the costs of the stripping activity shall be accounted for as an addition to or enhancement of an existing asset. In other words, this benefit will become a component of an existing asset, and is referred to in this [draft] Interpretation as the 'stripping campaign component'.

11. An entity shall classify the stripping campaign component as tangible or intangible according to the nature of the existing asset that it is a part of.

12. The stripping campaign component shall be specifically associated with the section of ore that becomes more accessible as a result of the stripping activity.

When shall the asset be initially recognised?

13. The stripping campaign component shall be recognised as the stripping activity takes place and the costs of creating that asset are incurred.

14. Recognition of the stripping campaign component will cease when the stripping campaign ends.

How shall the asset be measured initially?

15. The stripping campaign component shall be measured initially at cost; that is, the accumulation of costs directly incurred to perform the stripping activity, such as haulage, waste transportation, materials consumed, costs of machinery employed, labour and fuel.

16. Some ancillary activities may be incurred in connection with preparing the mine for production, but are not necessary for the stripping campaign to continue as planned, for example, building an access road in the area in which the stripping campaign is taking place. The costs associated with these operations shall not be included in the cost of the stripping campaign component. These costs shall be recognised as assets or expensed in accordance with other IFRSs.

How shall the asset be subsequently measured?

17. After initial recognition, the stripping campaign component shall be carried at its cost less amounts depreciated or amortised, and less any impairment charges.

18. The stripping campaign component shall be depreciated or amortised in a rational and systematic manner, over the reserves that become available as a result of the stripping campaign. In the mining industry, the units of production method is generally the appropriate method.

19. The reserves used to depreciate or amortise the stripping campaign component will normally differ from those used to depreciate or amortise the mine and related life-of-mine assets, because the stripping campaign will normally only give access to a portion of the total reserves.

20. If the extraction of the ore specifically associated with the stripping campaign component is temporarily suspended, any remaining balance on the component shall be considered for impairment.

21. If the extraction of the ore specifically associated with the stripping campaign component ceases because no further future economic benefits are expected to be received, then any remaining balance on the component shall be considered for derecognition.

Effective date

22. An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date to be set at three months after the [draft] Interpretation is finalised]. If an entity applies this [draft] Interpretation for a period beginning before [date to be set at three months after the draft Interpretation is finalised], it shall disclose that fact.

Transition

23. An entity shall apply this [draft] Interpretation prospectively to production stripping costs incurred on or after [date to be set 3 months after the draft Interpretation is finalised]. Any existing stripping cost asset balances at that date shall be reclassified as a component of the mine asset to which the stripping activity related and depreciated/amortised over the specific ore quantity to which the stripping activity related. If there is no identifiable ore to which that component can be associated, it shall be written off against profit or loss immediately.

Appendix A

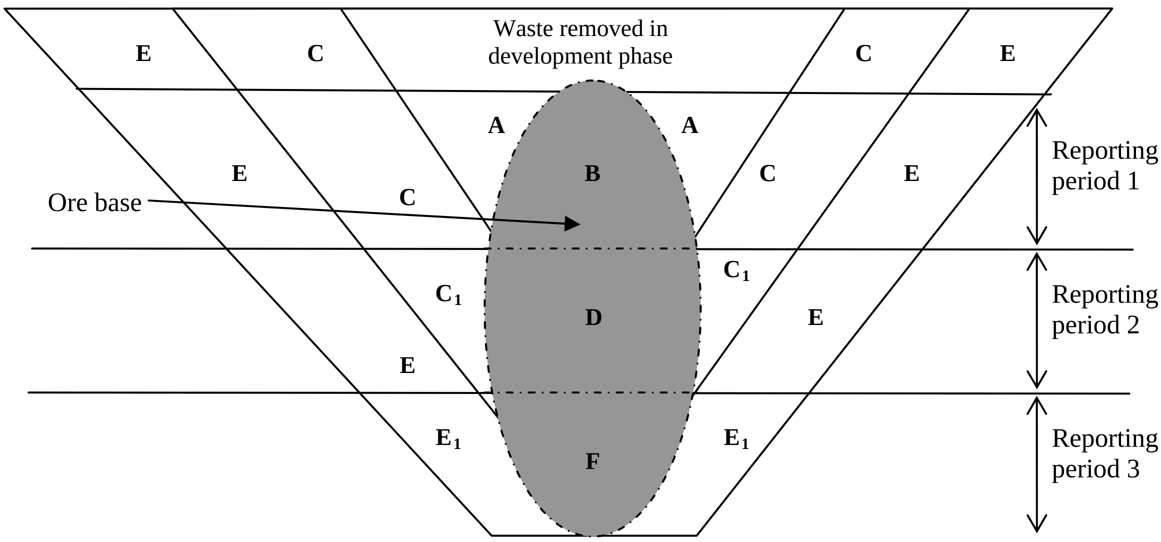
Application guidance

This Appendix is an integral part of the Interpretation.

How shall the asset be subsequently measured? (paragraph 18)

AG1 Paragraph 18 of this Interpretation specifies that the stripping campaign component shall be depreciated or amortised over the reserves that become available as a result of the stripping campaign. Paragraph 19 states that the reserves used to depreciate or amortise the stripping campaign component will normally differ from those used to depreciate or amortise the mine and related life-of-mine assets. In other words, a portion of the total reserves, and not the entire body of reserves expected to be extracted.

AG2 The following diagram is to provide further clarity on what is meant by ‘a portion of the total reserves’:



AG3 Referring to the diagram above, production stripping activity in reporting period 1 is represented by areas labeled ‘A’. The costs of this activity have been incurred to gain access to the ore in area ‘B’. *Area B is a portion of the total ore reserve. The total ore reserve is represented by B + D + F. Therefore, areas D and F are also ‘portions of the total ore reserve’.* Assuming that all the ore in area B is

extracted during reporting period 1, all the production stripping costs represented by area A will be included as costs of production in reporting period 1.

AG4 Consider now areas C in the diagram above. These are areas of production stripping activity undertaken in reporting period 1, in order to gain access to ore in area D. Area D is only going to be extracted in reporting period 2. The production stripping costs represented by areas C are therefore not included as costs of production in reporting period 1. Under the [proposed] approach in the Interpretation, the costs represented by areas C will be capitalised as a stripping cost component in reporting period 1.

AG5 In reporting period 2, all the ore in area D is extracted. The stripping cost component capitalised in reporting period 1 (the production stripping costs incurred in areas C) will be depreciated/amortised in reporting period 2, as the ore which they were incurred to clear, is extracted. In addition, during reporting period 2, production stripping activity takes place in areas C_1. This activity is similar to that which took place in area A in reporting period 1, above. Since all the ore in area D is extracted during reporting period 2, all the production stripping costs represented by area C_1 will be included as costs of production in reporting period 2.

AG6 Consider now areas E in the diagram above. These are areas of production stripping activity undertaken in reporting period 2, in order to gain access to ore in area F. Area F is only going to be extracted in reporting period 3. The production stripping costs represented by areas E are therefore not included as costs of production in reporting period 2. Under the [proposed] approach in the Interpretation, the costs represented by areas E will be capitalised as a stripping cost component in reporting period 2.

AG7 In reporting period 3, all the ore in area F is extracted. The stripping cost component capitalised in reporting period 2 (the production stripping costs incurred in areas E) will be depreciated/amortised in reporting period 3, as the ore which they were incurred to clear, is extracted. In addition, during reporting period 3, production stripping activity takes place in areas E_1. This activity is similar to that which took place in area C_1 in reporting period 2. Since all the ore in area F is extracted during reporting period 3, all the production stripping costs represented by area E_1 will be included as costs of production in reporting period 3.

Basis for Conclusions on IFRIC Interpretation [X] *Accounting for Stripping Costs in the Production Phase*

This Basis for Conclusions accompanies, but is not part of, IFRIC [X].

Introduction

BC1 This Basis for Conclusions summarises the IFRS Interpretations Committee's considerations in reaching its consensus. Individual Committee members gave greater weight to some factors than to others.

Background

BC2 The Committee received a request to issue guidance on the accounting for waste removal (stripping) costs incurred in the production phase of a mine. Accounting for production stripping costs is challenging because such costs incurred may benefit both future and current period production, and there is no specific guidance in IFRS addressing this issue.

BC3 Consequently, there is diversity in practice in accounting for production stripping costs – some entities expense production stripping costs as a cost of production and some entities capitalise some or all production stripping costs, based on a life-of-mine ratio calculation, or similar basis. The Committee decided to develop a draft Interpretation in response to that divergence in practice.

BC4 The Committee decided to include the concept of the stripping campaign as the unit of account in this Interpretation. 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.

BC5 The number, timing and extent of the stripping campaign will depend on a number of factors eg. 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.

Scope

BC6 This draft Interpretation proposes guidance on the accounting for stripping costs incurred in surface mining activity. In developing the draft Interpretation, the Committee decided to exclude oil and natural gas extraction and underground mining activities. The Committee understood that stripping activity occurs predominately in surface mining activities, and decided to confine the scope to these circumstances.

BC7 The Committee decided to exclude 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.

Consensus

Is the definition of an asset met?

BC8 The Committee decided that, by incurring costs to remove waste, an entity may create a benefit; that is, of improved access to the mineral ore body. 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 reserves therefore becomes easier and less costly.

BC9 Where the access benefit created by the stripping activity meets the definition of an asset, the Committee decided that the benefit created was more akin to an addition to or improvement of an existing asset, than an asset in its own right. Practically, the benefit might add to or improve a variety of existing assets, for example the mine property (land), the mineral reserve itself being used in the construction of the mine, or an asset that originated in the mine development phase.

BC10 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 – this will follow the nature of the underlying asset to which the benefit relates.

BC11 The Committee decided that there is a difference between stripping activity that is 'routine', and that which takes the form of a specific and directed effort to gain access to a particular section of the ore.

BC12 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, since 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. The costs of routine stripping should be accounted for as part of the cost of inventory produced in the current reporting period.

BC13 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 overlaps into the following reporting period. The Committee decided that an entity would not necessarily need to capitalise the costs of such routine stripping. The entity would need to consider the significance and materiality of that benefit in determining whether capitalising the costs of such routine stripping activity was necessary.

BC14 The Interpretation refers to a 'stripping campaign' in order to distinguish a significant and focused stripping effort from routine stripping. By nature, they involve a significant 'push back' or removal of waste material in order to widen or deepen an existing pit, or 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 definition of an asset will usually be met.

BC15 At the same time as the component is recognised, it is important that the entity links the costs incurred with the ore that will be accessed as a result of the stripping campaign. This specific identification approach links the stripping activity to the benefit created and is key to the subsequent amortisation of the asset, which will take place as the ore is mined.

When shall the asset be initially recognised?

BC16 The stripping campaign component is an accumulation of costs incurred, as a result of stripping activity, that meet asset recognition criteria (paragraph 49(a) of the *Framework).* Therefore, the component is recognised as the stripping activity takes place.

BC17 The stripping campaign is something which has a defined beginning and end, within the greater life of the mine (like a 'subset' of the mine life). A mine may have more than one stripping campaign planned into the production phase. It was not envisaged by the Committee that a stripping campaign would last the entire duration of the mine.

BC18 The Committee decided to follow a similar principle as that in paragraph 20 of IAS 16 *Property, Plant and Equipment* in determining when the recognition of costs of a stripping campaign component should end. Paragraph 20 of IAS 16 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. Therefore, once a section of land is stripped to the extent required in order to achieve this objective, capitalisation of stripping costs relating to that section of land should cease. Subsequent stripping costs should be separately assessed to determine whether they represent routine stripping, or a new stripping campaign.

How shall the asset be measured initially?

BC19 The Committee decided to follow the principle in paragraph 21 of IAS 16, to determine whether ancillary costs should be included in the measurement of the stripping campaign component. It is likely in practice that other development activities may take place at the same time and in the same area as the stripping activity, but are not of a waste-removal nature. The Committee was concerned that the costs relating to these ancillary activities would be capitalised to the stripping campaign component in error. The Committee decided therefore that ancillary costs should not be capitalised as part of the stripping campaign component.

How shall the asset be subsequently measured?

BC20 The Committee decided that the most rational and systematic way of depreciating or amortising the cost of the stripping campaign component would be over the units of ore that benefited from the campaign. This is an application of the units of production method which is currently used in practice, but which is focused only on the ore that is directly accessed through the stripping campaign. Because the stripping campaign is a subset of the entire mine, the stripping campaign component will always be depreciated or amortised over a lesser period than the life of the mine.

BC21 There may be circumstances when extraction stops, yet a non-depreciated or unamortised balance on a stripping campaign component remains. This may happen, for example, if there is less actual ore to extract than previously estimated. In other circumstances, mine operations may be temporarily suspended - for example if it became difficult or uneconomic to continue operations as planned, but with the intention of revisiting the site for further extraction in the future. In both of these sets of circumstances, the stripping campaign component should be considered for impairment, according to the principles in IAS 36 *Impairment of Assets.*

BC22 If there are no longer future economic benefits expected from the ore to which a stripping campaign relates, then the stripping campaign component should be considered for derecognition.

Transition

BC23 Due to 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. The Committee therefore decided that the draft Interpretation should require prospective application to production stripping costs incurred on or after its effective date.