Project **Extractive Activities**

Topic **Accounting for stripping costs in the production phase – attribution of the stripping cost asset**

## Objective of this paper

1. Paper 2A *Accounting for stripping costs in the production phase – costs of waste removal and the associated benefit* discussed the concept that, by incurring costs to remove waste, the entity creates a benefit. That benefit is improved access to the mineral ore body. This benefit is realised when the entity mines the section of the ore body which has been cleared of waste, or 'stripped'. This benefit could be realised in the current period, in a future period, or a combination of the two.

2. Paper 2A recommends that waste removal costs associated with a benefit to be realised in a future period should be capitalised as an asset, according to the principles of IAS 16 *Property, Plant and Equipment.*

3. The objective of this paper is to discuss the subsequent attribution (or amortisation) of this asset. Attribution means ascribing or assigning to, or allocating to. It is a phrase that is commonly used in the mining industry to mean allocating capitalised costs to inventory. Mining companies often use 'attribution' and 'amortisation' interchangeably.

## Current guidance on amortisation (depreciation) in IFRS

4. Both IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* contain principles about amortisation (or depreciation) of non-current assets. The *Framework* also contains principles on recognition of the cost of use of non-current assets.

5. IAS 16 paragraph 6 defines depreciation as a systematic allocation of the depreciable amount of an asset over its useful life. Paragraph 43 goes on to state

that 'Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately'.

6. IAS 38 paragraph 8 defines amortisation as 'the systematic allocation of the depreciable amount of an intangible asset over its useful life'. This principle only applies to intangible assets with finite useful lives (IAS 38.97)[1].

7. General conceptual support of the above is provided in paragraph 96 of the *Framework* which states that 'when economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated with the using up of assets such as property, plant, equipment, goodwill, patents and trademarks; in such cases the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire'.

8. Both of the standards therefore require that assets should be depreciated or amortised in a *systematic manner.* IAS 16 further requires the *componentisation approach* to be applied to the depreciation of the cost of assets – where the unit of measure is the separate significant parts of an asset, this is more representative of the consumption pattern of the asset than the 'item as a whole' (IAS 16 BC26 and BC27).

*9.* The staff think that the basic principle relating to the attribution of the asset created by the stripping campaign should be that the asset is *attributed over ore reserves in a systematic and rational manner.*

| **Question 1 for the IFRIC** |
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| Does the IFRIC agree with the basic principle for attribution of the asset, as stated in paragraph 9? |

## Methods of attribution observed in the mining industry

[1] Paragraph 107 of IAS 38 states that intangible assets with *indefinite* useful lives are not amortised.

10. There are various methods of attribution currently being applied in the mining industry. The following two methods are those most commonly observed in practice:

    (a) Proportionate performance ratio method;

    (b) Units of production method

11. Each of these methods will be discussed in more detail below.

### The proportionate performance ratio method

12. This method attributes unamortised capitalised costs over each unit of ore produced on an activity-based ratio. A strip ratio[2] is an example of such an activity-based ratio.

13. Paper 2A discussed the strip ratio approach as a method of identifying waste removal costs to be capitalised. An entity will calculate the *actual* strip ratio in a period, and will compare that to the *average or life-of-mine* strip ratio (that was calculated when the mine plan was compiled). To the extent that the actual strip ratio is *greater than* the average strip ratio, waste removal costs will be capitalised. Following on from this, in the event the actual strip ratio is *lower than* the average strip ratio, waste removal costs will be attributed.

14. The staff understands that the strip ratio must be applied as a 'package deal' – if used, it should be used as the basis of capitalisation in order for it to be used as the basis for attribution. In Paper 2A, pros and cons of the strip ratio approach were discussed. The staff recommendation set out in paper 2A was that the strip ratio approach should not be used for capitalisation of waste removal costs.

### The units of production method

15. Under this method, the attribution of the stripping cost asset is based on the units of ore to be extracted from the mine.

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[2] The basic strip ratio formula is:

$$\frac{\text{Volume of overburden } (m^3)}{\text{Weight of ore (tonnes)}}$$

16. The staff think attribution of the stripping cost asset based on units of ore extracted is a systematic and rational basis. Extending this concept to fit in conceptually with the staff's recommendations in paper 2A, the staff would suggest that *the stripping cost asset is attributed over the specific units of ore that benefited from the stripping activity*. This approach is also conceptually similar to the componentisation approach required by IAS 16, as discussed in paragraph 8.

17. As discussed in paper 2A, practically, costs associated with a particular stripping campaign can be isolated and 'tagged' to an area being stripped. Mining entities usually have the ability to track volumes of ore to be stripped and mined. Typically, a stripping campaign will be identified at mine planning stage, some time in advance of it actually taking place. Therefore, when the campaign actually takes place, the entity will be in a position to track the related costs and activity. Accordingly, attribution of the capitalised costs over the specific volume, as the benefit inherent in the asset is realised, would be consistent with the basis on which those costs were capitalised.

**Staff recommendation**

18. Extending the basic principle discussed in paragraph 9, the staff recommend that the asset created by the stripping campaign should be attributed over the *specific ore reserves that benefited from the campaign*.

| **Question 2 for the IFRIC** |
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| 2.1 Does the IFRIC agree with the staff recommendation in paragraph 18?<br><br>2.2 Does the IFRIC have any further comments or suggestions for the staff on this topic? |