Project **Extractive Activities**

Topic **Accounting for stripping costs in the production phase of a surface mine – comment letter analysis**

Introduction and purpose of this paper

1. The IFRS Interpretations Committee received a request in 2009 for guidance on how to account for stripping costs in the production phase of a surface mine. The Committee took the issue onto its agenda in January 2010, and in August 2010 it published for public comment a Draft Interpretation *Stripping Costs in the Production Phase of a Surface Mine.* The 90 day comment period ended on 30 November 2010.
2. The purpose of this paper is
   (a) to present a high-level analysis of the comments received on the Draft Interpretation, and
   (b) to discuss the next steps for the Draft Interpretation.

Summary background of the respondents

3. 50 comment letters were received on the Draft Interpretation. A breakdown of the demographic information on the respondents is provided in Appendix A.

Overall summary of the comments received

4. The respondents were broadly supportive of the development of an Interpretation on this topic. Their specific comments and suggestions with respect to the guidance in the Draft Interpretation are dealt with below.

5. A few respondents did not think that an Interpretation on this topic was necessary. Some stated[1] that stripping costs could be adequately accounted for by applying the principles in IAS 16 *Property, Plant and Equipment*. There was support for dealing rather with the issue of production stripping costs in the broader Extractive Activities project[2]. It was also raised that the current diversity in practice is due to the underlying geological differences in mines, and may not be resolved by the development of principles around accounting for production stripping costs[3].

Comments received in response to the questions asked in the Draft Interpretation

Question 1 – Definition of a stripping campaign

The proposed Interpretation defines a stripping campaign 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. The stripping campaign is planned in advance and forms 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. Do you agree that the proposed definition satisfactorily distinguishes between a stripping campaign and routine waste clearing activities? If not, why?

Issues raised

[1] BHP Billiton; Xstrata plc

[2] Grant Thornton International

[3] PwC ; Accounting Standards Board (UITF); Deloitte

6. Broadly speaking, the respondents did not agree that the definition satisfactorily distinguished between a stripping campaign and routine waste clearing activities. The main points raised are discussed below.

7. Firstly, some commentators[4] stated that the definition of a stripping campaign is vague and generic, and a number of the aspects of the definition apply to routine stripping too – like ‘systematic process’. They noted that it is not clear what the Committee means by ‘aggressive’, that this is a subjective concept and may lead to diversity in interpretation and application. It was noted that in some types of surface mining operations (e.g. drag lines used in coal mining), it would be difficult to determine a stripping campaign from routine stripping, using the proposed definition.

8. Secondly, some commentators[5] asked why it was necessary to differentiate between routine stripping and stripping campaigns for the following reasons:

    (a) introducing two new approaches for accounting for stripping costs (accounting differently for routine stripping costs and stripping costs incurred as part of a stripping campaign), in addition to the already accepted practice of accounting for development stripping (pre-stripping) was onerous, and would be unnecessarily complex for practical application.

    (b) routine stripping costs also form part of the mine plan and sometimes may create a future benefit (they note that this issue is dealt with in BC12-13 of the Draft Interpretation, but are ‘unconvinced by the reasoning’[6]), and that all stripping activity ultimately contributes to improving the access to the ore body.

Suggestions offered in the letters

[4] Anglo American; SAICA, Gold Fields Limited; Xstrata plc

[5] Ernst & Young; BHP Billiton; Accounting Standards Board (UITF); Chartered Accountants Ireland; ICAEW; Canadian Accounting Standards Board; Deloitte

[6] BDO

9. A few commentators suggested capitalising all stripping costs incurred. However, there was more support[7] for capitalising those stripping costs that meet the definition of an asset, as discussed in paragraphs 7(a) – (c) of the Consensus, without needing to distinguish between costs that are routine, and costs that are incurred under stripping campaigns.

10. Others stated that if the Committee were to go ahead with the concepts of routine stripping and stripping campaigns, in order for the definition of a stripping campaign to be properly understood, routine stripping would need to be defined[8]. These commentators also encouraged the Committee to expand and/or reword and clarify the definition of a stripping campaign.

11. Although the issue of classification was not addressed in the questions to the Draft Interpretation, accounting for stripping costs under the principles of IAS 16, and not as intangible assets under IAS 38 *Intangible Assets,* was supported among the commentators[9].

Question 2 – Allocation to the specific section of the ore body

> The proposed Interpretation specifies that the accumulated costs recognised as a stripping campaign component 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. The units of production method is applied unless another method is more appropriate.
>
> (a) Do you agree with the proposal to require the stripping campaign component to be depreciated or amortised over the specific section of the ore body that becomes accessible as a result of the stripping campaign? If not, why?
>
> (b) Do you agree with the proposal to require the units of production method for depreciation or amortisation unless another method is more appropriate? If not, why not?

Issues raised – question 2(a)

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[7] BDO; ENRC

[8] Ernst & Young; De Beers

[9] Xstrata plc; BDO; De Beers

12. Broadly speaking, there was conceptual agreement amongst the commentators on specific depreciation/amortisation. Three main practical points were raised, however.

13. Firstly, the section of the ore body that was planned for extraction may change, as more information is gained about it, as a result of the mining activities. For example, additional ore may be identified that was not previously part of the mine plan, or alternatively a section of ore may turn out to be infeasible to extract. Changes in the ore base specified for depreciation/amortisation of the related stripping costs such as these would require a rework of the depreciation/amortisation charge.

14. Secondly some[10] state that, in addition to benefiting the 'specific' ore that becomes directly accessible as a result of stripping activity, the activity can also benefit a further part of the ore body, depending on the geology of the ore distribution. An example of this issue is provided by one commentator, as follows: 'consider a stripping campaign undertaken to ultimately provide access to higher grades of ore at deeper levels relative to the marginal (very low grade) directly accessible ore. It would not be appropriate to depreciate stripping costs solely over this marginal directly accessible section as this is not where the economic benefits of the stripping will be derived nor does it align with the economic decision to undertake that stripping campaign.'

15. Thirdly, some commentators state that the specific depreciation/amortisation method could be complex to implement, especially in cases where the ore is widely distributed and mined in a number of pits. The method could also be operationally costly, due to the 'complexity of accounting and record keeping required'.

Issues raised – question 2(b)

[10] Canadian Accounting Standards Board; PwC; Deloitte

16. Broadly, most commentators agreed with using the units of production method for depreciation/amortisation. The point was made by a few commentators[11] however that the proposed Interpretation should not mandate the use of the units of production method. Doing so 'regardless of underlying economic substance' may 'conflict with paragraph 60 of IAS 16 which requires depreciation to 'reflect the pattern in which the asset's future economic benefits are expected to be consumed'[12].

Suggestions offered in the letters – questions 2(a) and (b)

17. Some commentators[11;12] suggested that the depreciation/amortisation principles provided in paragraph 60 of IAS 16 would provide a suitable principle for depreciating/amortising stripping costs on a systematic and rational basis. There was some support for using the life of mine basis, as opposed to the specific allocation basis proposed in the Draft Interpretation.

18. Some suggested, if the Committee were to go forward with the specific allocation basis, then it needed to address the fact that ore bases may change, as discussed in paragraph 14, above. Further, that the Committee should consider removing the word 'directly' in the sentence '..over the specific section of the ore body that becomes directly accessible as a result of the stripping campaign', thus allowing the costs to be allocated over a wider ore base.

Question 3 – Disclosures

The proposed Interpretation will require the stripping campaign component to be accounted for as an addition to, or an enhancement of, an existing asset. The stripping campaign component will therefore be required to comply with the disclosure requirements of that existing asset. Is the requirement to provide disclosures required for the existing asset sufficient? If not, why not, and what additional specific disclosures do you propose and why?

Issues raised

[11] Extractive Activities Working Group

[12] ICAEW

19. Almost all commentators supported only requiring disclosures for the existing asset, with no additional disclosures considered necessary.

20. However, there was some debate about *which* existing asset the stripping cost component should form a part of. Most commentators supported the stripping costs component forming part of property, plant and equipment (PPE) (per IAS 16), and not an intangible asset (per IAS 38).

21. In addition, there was some support for stripping costs to be presented as a separate class of PPE[9], as this would provide better information for users, especially if capitalised stripping cost balances are material. It was noted that IAS 16 paragraph 58 envisages that quarries and landfill are within the scope of IAS 16, and perhaps this rationale could be used for presenting stripping costs as a separate class of PPE.

Question 4 – Transition

Entities would be required to apply the proposed Interpretation to production stripping costs incurred on or after the beginning of the earliest comparative period.

(a) Do you agree that this requirement is appropriate? If not, what do you propose and why?

The proposed Interpretation requires any existing stripping campaign component to be recognised in profit or loss, unless the component can be directly associated with an identifiable section of the ore body. The proposed Interpretation also requires any stripping cost liability balances to be recognised in profit or loss on transition.

(b) Do you agree with the proposed treatment of existing stripping cost balances? If not, what do you propose and why?

Issues raised - question 4(a)

22. This received broad support from the commentators. Some commentators noted that the Committee should consider that ‘on or after the beginning of the earliest comparative period’ would require some retrospective adjustment, and possibly the use of hindsight.

Suggestions offered in the letters

23. A few commentators suggested that retrospective application was preferable from the point of view of comparability of information, but they noted that this

would often be impractical and unduly onerous for a number of entities. One suggestion[13] was for the Interpretation be prospectively applied from the beginning of the next annual reporting period, after it becomes effective.

Issues raised - question 4(b)

24. The majority of the commentators disagreed with recognising any existing stripping campaign component in profit or loss, if it cannot be directly associated with an identifiable section of the ore body. They argue that this is not in line with current requirements in IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*, and will cause unnecessary volatility in earnings.

25. Some commentators argued that it may be difficult and impractical to determine when and how existing stripping cost balances were incurred, and which ore body they relate to.

Suggestions offered in the letters

26. Commentators suggested that if existing stripping campaign components cannot be directly associated with an identifiable section of the ore body, that they be recognised in retained earnings at the beginning of the earliest period presented, consistent with IAS 8, and not in profit or loss.

27. Alternatively, some commentators suggested that existing stripping cost balances not be derecognised at all, but that they are depreciated/amortised over the remaining life of the mine.

Next steps

28. Having considered the comments received and the suggestions made by the commentators, the staff summarises below the main areas it thinks require further discussion by the Committee.

Question 1 for the Committee

[13] Xstrata plc

Does the Committee agree that it should continue with developing this Interpretation?

Whether or not to distinguish between routine stripping costs and stripping costs incurred during a stripping campaign

29. The alternatives to consider are the following:

    (a) Continue with the guidance as proposed, with clarification of the definition of 'stripping campaign' and providing a definition for 'routine' stripping costs, or

    (b) Capitalise those stripping costs that meet the definition of an asset, without distinguishing routine stripping costs from those incurred under stripping campaigns, or

    (c) Capitalise all stripping costs incurred during a period.

30. The staff note that the main reason for the development and inclusion in the Draft Interpretation of the concept of the stripping campaign, was to identify, as clearly as possible, the costs incurred as a result of stripping activity during the production phase, that may qualify for capitalisation. During its deliberations, the Committee noted that a stripping campaign would be indicative of activities involved in accessing an ore body, and would provide a basis to identify these costs from other production activities, waste removal and remediation activities that may all be taking place at the same time. This would then give a basis for measurement of the stripping campaign component. In the staff's view, neither alternatives (b) or (c) above would provide the same basis for identification of costs to be capitalised.

Question 2 for the Committee
2(a) Does the Committee have any preliminary views on which of the alternatives (a), (b) and (c) in paragraph 30 above, the staff should analyse further for the next meeting?

> 2(b) In the absence of a stripping campaign concept, how would the Committee like to approach the determination of the amount of costs that would qualify for capitalisation?

Whether to state that capitalised stripping costs should be accounted for as assets under IAS 16, and remove the choice between IAS 16 and IAS 38

31. The alternatives to consider are the following:

    (a) Continue with the guidance as proposed, leaving it up the judgment of the entity as to whether the stripping cost asset should be tangible or intangible in nature, or

    (b) Require that the stripping cost asset is accounted for according to the principles of IAS 16.

Question 3 for the Committee
Does the Committee have any preliminary views on which of the alternatives (a) and (b) in paragraph 31 above the staff should analyse further for the next meeting?

Whether to continue to require depreciation/amortisation according to the specific identification approach

32. The alternatives to consider are the following:

    (a) To continue requiring the specific identification approach as proposed, with additional guidance for accounting for changes in the specific ore base, after depreciation/amortisation has begun. In addition, to consider removing the word 'directly' from the requirements, so that there is more flexibility in the approach, but without permitting the use of life-of-mine, or

    (b) To continue requiring the specific identification approach, with the proviso that if the approach was unreasonably difficult to apply, then to apply a principle for depreciating/amortising stripping costs that would be both systematic and rational (the staff note that this may mean that entities opt to apply the life-of-mine approach), or

(c) To not require the specific identification approach, but to require the application of the current principles in IAS 16 for depreciation/ amortisation.

Question 4 for the Committee
Does the Committee have any preliminary views on which of the alternatives (a), (b) and (c) in paragraph 32 above the staff should analyse further for the next meeting?

Transition considerations

33. The alternatives in respect of the transition guidance in paragraph 21 of the Draft Interpretation are as follows:

(a) To continue with the requirements as proposed, that is that the entity shall apply the proposals to production stripping costs incurred on/after the beginning of the earliest period presented, or

(b) To require prospective application, but from the beginning of the next annual reporting period after the Interpretation becomes effective.

Question 5 for the Committee
Of the alternatives (a) and (b) in paragraph 33 above, does the Committee have any preliminary views on which alternative the staff should analyse further for the next meeting?

34. The alternatives in respect of paragraph 22 of the Draft Interpretation are as follows:

(a) Continue with the requirements as proposed, that is to require that any existing stripping campaign component that cannot be directly associated with an identifiable section of the ore body, be recognised in profit or loss at the beginning of the earliest period presented, or

(b) Require that any existing stripping campaign component that cannot be directly associated with an identifiable section of the ore body, be recognised in opening retained earnings at the beginning of the earliest period presented, or

(c) Require that any existing stripping campaign component that cannot be directly associated with an identifiable section of the ore body, be depreciated/amortised over the remaining life of the mine.

Question 6 for the Committee
Of the alternatives (a), (b) and (c) in paragraph 34 above, does the Committee have any preliminary views on which alternative the staff should analyse further for the next meeting?

Other issues raised in the letters

35. A number of other issues were raised in the letters received. The staff think that the following issues are worth further consideration:

(a) The illustrative example:

The illustrative example is too simplistic and is not representative of surface mines. Some[14] commentators suggested the example is removed from the Interpretation before issue.

(b) Impairment of a component:

The Committee needs to provide guidance on how a component is to be impaired, if that is what it meant. Some commentators[15] said that the wording of paragraph 19 of the Draft Interpretation needs clarification, where it states ‘An entity should consider the stripping campaign component for impairment in accordance with IAS 36’. These commentators asked whether it was the stripping

[14] Vattenfall; Australian Accounting Standards Board; Deloitte; Santos

[15] Canadian Accounting Standards Board, BDO

campaign component, or the cash generating unit (CGU) to which it belonged, that would be assessed for impairment.

(c) Definition of the 'production phase':

Some commentators[16] suggested that the Draft Interpretation should include a definition of the production phase of a mine, since this is the scope of the guidance. They state that the line between the production phase and other phases in a mine's life cycle is a fine one to define in practice, so some guidance on this in the Interpretation would be useful.

36. Also, there was support in a number of the comment letters[17] for the Extractives Activities project to be included on the Board's future agenda.

Question 7 for the Committee	
7.1	Does the Committee have preliminary views on the inclusion of the illustrative example in the final Interpretation?
7.2	Does the Committee think that further guidance should be given as to whether the component or the CGU to which it belongs should be the subject of impairment according to IAS 36 *Impairment of Assets*?

37. The staff recommend that whether a definition of the production phase is included in the final Interpretation is a point to be considered at a future meeting, dependent on the outcome of other issues.

[16] Chartered Accountants Ireland; Australian Accounting Standards Board

[17] ICAEW

Appendix A – Demographic information of respondents

A1. This Appendix provides demographic information on the respondents to the exposure draft *Removal of Fixed Dates for First-time Adopters* published in August 2010. The table below contains a full list of respondents to the exposure drafts, categorised the respondents by type and geography.

CL #	Respondent	Respondent type	Geography
1	Heemskirk	Unknown	Unknown
2	Holcim	Preparer	Switzerland
3	Accounting Standards Board (UITF)	Standard setter	UK
4	Linus Low	Individual	Unknown
5	L. Vrnkatesan	Individual	India
6	Swedish Financial Reporting Board	Standard setter	Sweden
7	SwissHoldings	Member organisation	Switzerland
8	Grant Thornton	Accounting firm	International
9	Representatives of the Australian Accounting Profession	Member organisation	Australia
10	Gold Fields	Preparer	South Africa
11	Institute for the Accountancy Profession in Sweden (FAR)	Standard setter	Sweden
12	Australian Accounting Standards Board	Standard setter	Australia
13	Xstrata	Preparer	International
14	Vattenfall	Preparer	Sweden
15	Accounting Interpretations Committee (AIC)	Standard setter	Germany
16	Japan Foreign Trade Council	Member organisation	Japan
17	Chartered Accountants Ireland	Standard setter	Ireland
18	Extractive Activities Working Group, member companies including: - AngloGold Ashanti - Arch Coal Inc - Barrick Gold Corporation - Freeport-McMoRan Copper & Gold Inc	Discussion group	International

	- Goldcorp Inc. - Newmont Mining Corporation - Pan American Silver Corp. - Peabody Energy Corporation - Rio Tinto Plc - Thompson Creek Metals Company Inc - The Graff Consulting Group LLC		
19	ICAEW	Accountancy Body	UK
20	Accounting Standards Board (AcSB)	Standard setter	Canada
21	ENRC	Preparer	International
22	The Japanese Institute of Certified Public Accountants	Standard setter	Japan
23	International Association of Consultants, Valuators and Analysts	Member organisation	International
24	BDO	Accounting firm	International
25	Acteo	Member organisation	France
26	De Beers	Preparer	South Africa
27	Mr Khalid Khowaiter	Individual	Unknown
28	PricewaterhouseCoopers	Accounting firm	International
29	Deloitte	Accounting firm	International
30	Korea Accounting Standards Board (KASB)	Standard setter	Korea
31	Santos	Preparer	UK
32	Ernst & Young	Accounting firm	International
33	The Norwegian Accounting Standards Board	Standard setter	Norway
34	South African Institute of Chartered Accountants (SAICA)	Standard setter	South Africa
35	Anglo American	Preparer	International
36	The Association of Chartered Certified Accountants (ACCA)	Accountancy Body	UK
37	KPMG	Accounting firm	International
38	D K Miglani	Unknown	Unknown
39	OneSteel Limited	Preparer	Australia

40	BHP Billiton	Preparer	International
41	The Malaysian Accounting Standards Board (MASB)	Standard setter	Malaysia
42	The Italian Standard Setter (OIC)	Standard setter	Italy
43	Canadian Securities Administrators	Member organisation	Canada
44	Hong Kong Institute of Certified Public Accountants	Standard setter	Hong Kong
45	Securities and Exchange Board of India (SEBI)	Member organisation	India
46	Group of 100 (G100)	Member organisation	Australia
47	Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF)	Standard setter	Mexico
48	International Organisation of Securities Commissions (IOSCO)	Regulator	International
49	Federation of European Accountants (FEE)	Member organisation	Europe
50	European Financial Reporting Advisory Group (EFRAG)	Standard setter	Europe