Project **Extractive Activities**

Topic **Accounting for stripping costs in the production phase of a surface mine – comparison between the Draft Interpretation and the near final Interpretation**

## Introduction

1. The purpose of this paper is to highlight and discuss the differences between the Draft Interpretation *Stripping Costs in the Production Phase of a Surface Mine* that was issued for comment in August 2010, and the near final draft of the document that the Interpretations Committee is seeking to finalise. We refer to these two documents as the 'Draft Interpretation' and the 'near final Interpretation' respectively.

2. The discussion below follows the headings in the near final Interpretation as it is now drafted:

   (a) Background

   (b) Scope

   (c) Consensus

      (i) Recognition of production stripping costs as an asset;

      (ii) Initial measurement of the stripping activity asset;

      (iii) Subsequent measurement of the stripping activity asset; and

   (d) Effective date and transition (now as Appendix A)

3. The focus of the discussion is on technical concepts. We have not highlighted other changes in wording where they do not relate to a change in a technical concept.

## Background

### *Routine stripping costs versus the stripping campaign*

4. This section in the Draft Interpretation introduced the concepts of routine costs and stripping campaigns, and described what was meant by a stripping campaign. As a result of the broadly unfavourable comments received on the proposed need to differentiate between routine stripping costs and a stripping campaign, the Committee decided not to pursue these concepts.

5. The near final Interpretation expanded on the core concept that stripping activity creates a benefit of improved access to the ore body, by explaining that two benefits may accrue to the entity when it undertakes stripping activity. These two benefits are current period inventory and improved access for the future, as a result of the fact that the material surrounding the ore body is often a combination of ore and waste (paragraphs 4 and 5 of the near final Interpretation). It became clear from the outreach that we performed after the comment period ended that this was an important practical issue that should be taken into consideration.

## Scope

6. No changes were made to the scope of the near final Interpretation.

## Consensus

### *Recognition of production stripping costs*

*Recognition criteria*

7. The Draft Interpretation required the entity to apply the asset recognition criteria to the costs incurred as part of a stripping campaign. The purpose of this was to determine whether there was a future access asset to recognise. The near final Interpretation also requires the entity to apply the asset recognition criteria, but the Committee realised that, without the concept of the stripping campaign, it would be difficult for the entity to identify as clearly the stripping costs that might qualify for asset recognition.

8. The Committee therefore decided to revert to the concept of identification of the *component* of the ore body for which access had been improved, as part of the criteria for recognising stripping costs as an asset (paragraph 8). This component approach follows the principle of separating out parts of an asset that have costs that are significant in relation to the entire asset in IAS 16 *Property, Plant and Equipment* (paragraph 43 of IAS 16) and when the useful lives of those parts are different. The Committee thought that reverting to the existing principles in IAS 16 would avoid introducing the stripping campaign approach that respondents had thought would be onerous to identify and make operational. The component approach would still provide a link between the stripping costs incurred and the section (or subset) of the total ore body for which access was improved. This is also important for the subsequent depreciation or amortisation of the non-current asset.

*The non-current asset*

9. The 'stripping campaign component' was no longer a relevant name for the non-current asset, so the Committee decided on 'stripping activity asset' instead (paragraph 10). This stripping activity asset is still accounted for as an addition to an existing asset, but to avoid confusion over the use of the word 'component', the near final Interpretation refers to this asset as forming a 'part' of an existing asset (paragraph 11).

### *Initial measurement of the stripping activity asset*

10. In the absence of a stripping campaign that flags the fact that extra stripping effort has occurred and which circumscribes the stripping costs to be considered for recognition, a principle was needed in the near final Interpretation to (a) help the entity to realise that activity has taken place above the level expected for inventory production, and (b) to provide a rational and consistent basis for allocating the stripping costs for the identified component of the ore body between the future access benefit and the current-period production of inventory.

11. In some cases, the entity may be able to measure the separate cost of each benefit directly, but our understanding is that this will rarely be the case. Consequently, the Committee decided that the near final Interpretation should require the entity to use an allocation approach based on a production measure (paragraphs 16 and 17). This approach is based on the principle for accounting for joint products in IAS 2 *Inventories* (paragraph 14).

### *Subsequent measurement of the stripping activity asset*

12. Apart from some wording changes, there was no change to the requirements for subsequent measurement.

13. The Committee decided not to refer to impairment in the Consensus, as it had in the Draft Interpretation. It is the Committee's intention that the requirements of IAS 36 *Impairment of Assets* should apply to impairment of stripping activity assets, and it was concerned that if impairment was addressed in the Consensus, constituents might think that something different was required. This is explained in the Basis for Conclusions.

## Effective date and transition

14. There were a number of comments received on the suggested treatment of existing stripping activity asset balances at transition date for which there is no identifiable component of the ore body to associate them with. The Draft Interpretation required that these balances should be recognised in profit or loss

at the beginning of the earliest period presented. As a result of the suggestions received in the comment letters, and to align the transition provisions with the principles in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the near final Interpretation requires such balances to be recognised in opening retained earnings instead of in profit or loss.

15. The Committee also debated whether to include guidance on recognition of any existing stripping activity liability balances at transition date, as was the case in the Draft Interpretation. A number of commentators were confused by this reference, because they said that such balances were uncommon, or else that they had never come across such liability balances in practice. Our outreach supported this view and we have explained it in the Basis for Conclusions (paragraph BC22).

## Re-exposure of the near final Interpretation

16. We think, given the analysis in this paper of the changes that have been made to the near final Interpretation since the draft was exposed, that the changes are not significant. We recommend therefore that the near final Interpretation is not re-exposed.

| Question 1 for the Committee |
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| Does the Committee agree with the staff recommendation that the near final Interpretation is not re-exposed? |

## Vote to confirm consensus

17. If the Committee agrees that the near final Interpretation is not to be re-exposed, **we then ask the Committee to vote to confirm the Consensus**. If no more than four members vote against the proposal, the IASB will be asked to ratify the Interpretation at its September 2011 meeting.