Project	**Extractive Activities**
Topic	**Accounting for stripping costs in the production phase of a surface mine – draft [final] Interpretation**

IFRIC [X] STRIPPING COSTS IN THE PRODUCTION PHASE OF A SURFACE MINE

References

- *The Conceptual Framework for Financial Reporting*
- IAS 1 *Presentation of Financial Statements*
- IAS 2 *Inventories*
- IAS 16 *Property, Plant and Equipment*
- IAS 36 *Impairment of Assets*
- IAS 38 *Intangible Assets*

Background

1. In surface mining operations, entities may find it necessary to remove mine waste materials (overburden) to gain access to mineral ore deposits. This waste removal activity is known as 'stripping'.
2. During the development phase of the mine (before production begins), stripping costs are usually capitalised as part of the depreciable cost of building, developing and constructing the mine. Those capitalised costs are depreciated or amortised on a systematic basis, usually by 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.

4. The material removed in the production phase will not necessarily be 100 per cent waste; often it will be a combination of ore and waste. The ratio of ore to waste can range from uneconomic low grade to profitable high grade. Removal of material with a low ratio of ore to waste may produce some usable material, which can be used to produce inventory, but its removal might also provide access to deeper levels of material that have a higher ratio of ore to waste. There can therefore be two benefits accruing to the entity from the stripping activity: usable ore that can be used to produce inventory and improved access to further quantities of material that will be mined in future periods.
5. This Interpretation considers when and how to account separately for these two benefits arising from the stripping activity. This includes how to measure them both initially and subsequently.

Scope

6. This Interpretation applies to waste removal (stripping) costs that are incurred in surface mining activity, during the production phase of the mine.

Issues

7. The Interpretation addresses the following issues:
    a) recognition of production stripping costs as an asset;
    b) initial measurement of the stripping activity asset; and
    c) subsequent measurement of the stripping activity asset.

Consensus

Recognition of production stripping costs as an asset

8. An entity shall recognise production stripping costs as an asset if, and only if an entity can demonstrate all of the following:
    a) it is probable that the future economic benefit (improved access to the ore body) associated with the costs will flow to the entity;
    b) the entity can identify the component of the ore body for which access has been improved; and

c) the costs relating to the improved access to that component can be measured reliably.

9. To the extent that the benefit is realised in the form of inventory produced, the entity shall account for the costs in accordance with the principles of IAS 2 *Inventories*. To the extent that the benefit is the improved access to ore, the entity shall recognise these costs as a non-current asset. This Interpretation refers to this non-current asset as the 'stripping activity asset'.
10. The stripping activity asset shall be accounted for as an addition to, or as an enhancement of, an existing asset. In other words, the stripping activity asset will be accounted for as *part* of an existing asset.
11. An entity shall classify the stripping activity asset as tangible or intangible according to the nature of the existing asset of which it becomes part.
12. [An entity shall recognise the stripping activity asset when the production stripping activity takes place and the costs are incurred.
13. Recognition of the stripping activity asset shall cease when the entity has completed the waste removal activity necessary to fully access the identified component of the ore body.]

Initial measurement of the stripping activity asset

14. The entity shall measure the stripping activity asset initially at cost, this being the accumulation of costs directly incurred to perform the stripping activity that benefits the identified component of ore, plus an allocation of directly attributable overhead costs. Some incidental operations may take place at the same time as the production stripping activity, but which are not necessary for the production stripping activity to continue as planned. The costs associated with these incidental operations shall not be included in the cost of the stripping activity asset.
15. When the costs of the stripping activity asset and of the inventory produced are not separately identifiable, the entity shall allocate the production stripping costs between the inventory produced and the stripping activity asset on a rational and consistent basis.

16. In deciding upon the appropriate basis for this allocation, the entity could use an allocation basis that is based on a relevant production measure, calculated for the identified component of the ore body, and used as a benchmark to identify the extent to which additional activity of creating a future benefit has taken place. Examples of such measures include:

    a) cost of inventory produced compared with expected cost;

    b) volume of waste extracted compared with expected volume, for a given volume of ore production; and

    c) mineral content of the ore extracted compared with expected mineral content to be extracted, for a given quantity of ore produced.

Subsequent measurement of the stripping activity asset

17. After initial recognition the stripping activity asset shall be carried at cost less depreciation or amortisation and less impairment losses, in accordance with the existing asset of which it is a part.
18. The stripping activity asset shall be depreciated or amortised on a systematic basis, over the expected useful life of the identified component of the ore body that becomes more accessible as a result of the stripping activity. The units of production method is applied unless another method is more appropriate.
19. The expected useful life of the identified component of the ore body that is used to depreciate or amortise the stripping activity asset will differ from the expected useful life that is used to depreciate or amortise the mine itself and the related life-of-mine assets, unless the stripping activity provides improved access to the whole of the ore body.

Appendix A

Effective date and transition

This appendix is an integral part of the [draft] Interpretation and has the same authority as the other parts of the [draft] Interpretation.

A1 An entity shall apply this Interpretation for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies this Interpretation for an earlier period, it shall disclose that fact.

A2 An entity shall apply this Interpretation to production stripping costs incurred on or after the beginning of the earliest period presented.

A3 Each existing stripping activity asset balance as at the date from which this Interpretation is applied, which resulted from stripping activity undertaken during the production phase, shall be reclassified as a part of an existing asset to which the stripping activity related. Such balances shall be depreciated or amortised over the remaining expected useful life of the identified component of the ore body to which each stripping activity asset relates.

A4 If there is no identifiable component of the ore body to which that stripping activity asset relates, it shall be recognised in opening retained earnings at the beginning of the earliest period presented.

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 the costs that are incurred may benefit both future and current period production, and there is no specific guidance in IFRSs addressing this issue.

BC3 Consequently, there is diversity in practice in accounting for production stripping costs—some entities recognise production stripping costs as an expense (a cost of production), and some entities capitalise some or all production stripping costs, on the basis of a life-of-mine ratio calculation, or some similar basis and some capitalise the costs associated with specific betterments. The Committee decided to develop an Interpretation in response to that diversity in practice.

Scope

BC4 The Interpretation gives guidance on the accounting for stripping costs incurred in surface mining activity. In developing the Interpretation, the Committee decided not to include oil and natural gas extraction and underground mining activities. The Committee understood that stripping activity occurs predominantly in surface mining activities, and decided to confine the scope to these circumstances.

BC5 The Committee decided not to include stripping costs incurred during the development phase of the mine, because the Committee became aware that there is no significant diversity in practice in accounting for such costs.

Consensus

Recognition of production stripping costs as an asset

BC6 The Committee decided that an entity may create two benefits by undertaking stripping activity (and incurring stripping costs). These benefits are the extraction of the ore mined in the current period, and improved access to the ore body that is to be mined in a future period. The result of this is that the activity creates an inventory asset and a non-current asset.

BC7 The asset recognition criteria included in paragraph 8 of the Interpretation are those referred to in paragraph 4.44 of the *Conceptual Framework for Financial Reporting.* An additional criterion is, however, also included in the Interpretation for recognition of the stripping activity asset—that the entity can specifically identify the 'component' of the ore body for which access is being improved. All three criteria must be met for the costs to qualify for recognition as an asset. If the criteria are not met, the stripping costs will not be recognised as part of the cost of the mine property.

BC8 'Component' refers to the specific volume of the ore body for which future access is improved by the stripping activity. The identified component of the ore body would typically be a subset of the total ore body of the mine. A mine may have several components, which are identified during the mine planning stage. As well as providing a basis for measuring the costs reliably at recognition stage, identification of components of the ore body is necessary for the subsequent depreciation or amortisation of the stripping activity asset, which will take place as that identified component of the ore body is mined.

BC9 Identifying components of the ore body requires judgement. The Committee understands that an entity's mine plan will provide the information required to allow these judgements to be made with reasonable consistency.

BC10 The Interpretation also states that the stripping cost asset should be recognised as ‘part’ of an existing asset. ‘Part’ refers to the addition to, or improvement of, the existing asset to which the stripping activity asset relates. The Committee took the view that the stripping activity asset was more akin to a part of an existing asset, than an asset in its own right. The stripping activity asset might add to or improve a variety of existing assets, for example the mine property (land), the mineral deposit itself, an intangible right to extract the ore or an asset that originated in the mine development phase.

BC11 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 from the nature of the underlying existing asset to which the benefit relates.

BC12 [The Committee decided to follow a similar principle to that in paragraph 20 of IAS 16 *Property, Plant and Equipment* in determining when the recognition of costs of a stripping activity asset shall end. Paragraph 20 of IAS 16 states that recognition shall 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. Consequently, once a component of land is stripped to the extent required in order to achieve this objective, recognition of stripping costs relating to that component of land shall cease. Subsequent stripping costs shall be separately assessed to determine whether they meet the criteria stated in this Interpretation to be recognised as a stripping activity asset.]

Initial measurement of the stripping activity asset

BC13 IAS 16 paragraph 16(b) states that the cost of an item of property, plant and equipment comprises ‘any costs directly attributable to bringing the asset to the location and condition necessary...’ Examples of the type of costs that the Committee would expect to be included as directly attributable overhead costs (paragraph 14 of the Consensus) would be items such as salary costs of the mine supervisor overseeing that component of the mine, and an allocation of rental costs of any equipment which was hired specifically to perform the stripping activity.

BC14 The Committee thought that it was important to address incidental operations in the Consensus, similarly to the principle contained in paragraph 21 of IAS 16. The Committee is aware that a number of activities are carried out simultaneously in a mine operation, and it thought that it was important for the entity to be aware of what was production stripping activity, and what was not, when considering the measurement of the stripping activity asset. An example of such an incidental operation would be building an access road in the area in which the stripping campaign is taking place.

BC15 The Committee noted that, when inventory is produced at the same time as the stripping activity asset is created, it may be difficult in practice to measure the separate cost of each benefit directly. The Committee agreed that an allocation basis would be needed in order to separate the cost of the inventory produced and the cost of the stripping activity asset.

BC16 In its discussions of the most appropriate allocation basis, the Committee rejected any basis that was based on sales values. The Committee considered that such a basis would be inappropriate because it was not closely linked to the activity taking place. In addition, the Committee understood that applying such a basis would involve practical difficulties and that it would be costly in comparison to the benefit that it would provide. From the outreach performed by the staff, the Committee understood that identifying a sales price for ore that will be mined in the future can be difficult, given the volatility of market prices for many minerals. Further complexities may arise when more than one mineral is present (whether by-products or joint products) when the ore is extracted.

BC17 The Committee decided to require an allocation approach that was based on a relevant production measure, because a production measure can be a good indicator for the level of activity taking place in the mine. The production measure basis requires an entity to recognise that a level of activity has taken place beyond what would otherwise be expected for the inventory production in the period, and that may have given rise to a future access benefit.

Subsequent measurement of the stripping activity asset

BC18 The Committee decided that the most appropriate way of depreciating or amortising the cost of the stripping activity asset would be over the expected useful life of the identified component of the ore body that benefited from the activity. This is an application of the units of production method that is commonly used, but it is focused only on the identified component of the ore body for which access has been improved through the stripping activity. Because the life of the identified component is expected to be only a part of the entire life of the mine, the stripping activity asset will be depreciated or amortised over a shorter period than the life of the mine.

BC19 The Committee also decided that there was no need for specific impairment guidance to be given and expects that the principles in IAS 36 *Impairment of Assets* would be applied to the existing asset of which the stripping activity asset is a part, and not at the level of the stripping activity asset itself.

Transition

BC20 Because of the complex and lengthy nature of many mining operations, and the past 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 from doing so. The Committee therefore decided that the Interpretation shall require prospective application to production stripping costs incurred on or after the beginning of the earliest period presented.

BC21 The Committee decided to follow the principles in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and to require recognition of any existing stripping activity balances at transition date in opening retained earnings at the beginning of the earliest period presented, if such balances could not be identified with a remaining component of the ore body.

BC22 The Committee noted that any liability balances resulting from prior production stripping activity that existed at the transition date would not be recognised under the principles described in the Consensus. The Committee understood from the comments received on the Draft Interpretation that such balances were uncommon, and therefore did not think that it needed to provide any guidance on recognition of liability balances, because constituents may find it confusing.