Project **Extractive Activities**

Topic **Accounting for stripping costs in the production phase of a surface mine – supplementary paper on allocation methods**

Introduction

1. This paper follows the discussion by the IFRS Interpretations Committee on Thursday 5 May 2011 on the method of allocation of costs between current and future benefits, to be included in the final Interpretation. We were asked to bring back to the meeting a discussion of the various options to be considered in selecting a measurement basis, taking into account the comments made by the Committee at Thursday's session.

Discussion

2. The revised draft Interpretation presented in paper 2A states the following:

> 17. Where it is not possible to separately measure the cost of the stripping cost asset, the entity shall allocate the production stripping costs between the inventory produced and the stripping cost asset by applying a residual cost approach.
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> 18. The residual cost approach involves the entity measuring the cost of inventory produced using a standard cost methodology and allocating the residual costs incurred to the stripping cost asset. To do this, the entity calculates the standard or expected cost of accessing ore in the identified component of the mine. Where the cost incurred to mine the quantity of ore produced is higher than would be expected for that quantity of ore produced in that component of the mine, the amount of costs incurred in excess of that standard or expected cost are

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

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> deemed to be the cost of improving the access to ore to be mined in future periods. This excess cost shall be recognised as a stripping cost asset for that component of the mine.
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> 19. The standard or expected cost of accessing ore in a component of a mine is estimated at the start of the production phase for that component, and revised whenever additional information about that component of the mine, and about the costs expected to be incurred, becomes available.

3. At the Thursday meeting, the Committee were not supportive of requiring a specific approach, and they raised concerns about the concept of requiring standard costing as the basis of the residual cost calculation. The Committee were also not supportive of the relative benefit approach based on sales values as an alternative approach.

4. The Committee therefore asked us to reconsider the allocation approach, and to come up with one that is principle-based, and that includes some guidance on its application - but without being prescriptive.

An alternative approach

5. We favour an approach that is based on a comparison of the expected level of activity with the actual level of activity, and to account for the difference. Therefore, it would be necessary for the entity to develop expectations of activity metrics that are normal or expected for that component (part) of the ore body being mined, as a benchmark to be compared to actual activity.

6. In practice, such metrics may be based on a physical property, such as volume or mineral content, or may be based on costs. From the outreach we have done, we understand that mining entities do develop expectations of normal levels of production volumes, mineral contents and costs (and others), and that these expectations are regularly adjusted as more information becomes available over time.

7. Therefore, we suggest that a reasonable approach to recognising a stripping component of a mine and allocating a cost balance between current and future benefits would be one which compares an expected level of the identified metric

to the actual level, and where the actual level exceeds the expected level, this will provide a basis on which to allocate the cost between current and future benefits. Whether the metric is volume or cost based, would be up to the judgement of the entity.

8. We suggest re-wording the draft Interpretation as follows:

> 17. Where ~~it is not possible to separately measure~~ the costs of the stripping cost asset and the inventory produced are not separately identifiable, the entity shall allocate the production stripping costs between the inventory produced and the stripping cost asset on a rational and consistent basis. ~~by applying a residual cost approach~~
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> 18. The entity shall use an allocation basis that is based on a relevant production metric, calculated for an identified component of the mine, that can be used as a benchmark to identify the extent to which additional activity of creating a future benefit has taken place. Examples of such metrics may include:
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> (a) cost of inventory produced compared with expected cost;
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> (b) volume of waste extracted compared with expected volume, for a given volume of ore production; and
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> (c) Mineral content of the ore extracted compared with expected mineral content to be extracted.
>
> ~~18. The residual cost approach involves the entity measuring the cost of inventory produced using a standard cost methodology and allocating the residual costs incurred to the stripping cost asset. To do this, the entity calculates the standard or expected cost of accessing ore in the identified component of the mine. Where the cost incurred to mine the quantity of ore produced is higher than would be expected for that quantity of ore produced in that component of the mine, the amount of costs incurred in excess of that standard or expected cost are deemed to be the cost of improving the access to ore to be mined in future periods. This excess cost shall be recognised as a stripping cost asset for that component of the mine.~~
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> ~~19. The standard or expected cost of accessing ore in a component of a mine is estimated at the start of the production phase for that component, and revised whenever additional information about that component of the mine, and about the costs expected to be incurred, becomes available.~~

Questions for the Committee
(1) Does the Committee agree with the reworded measurement basis in the revised paragraphs 17 and 18 of the draft Interpretation, as stated above? (2) Does the Committee have any further wording suggestions for the staff to consider?

A note on recognition

9. The measurement principle described above requires the entity to recognise that unusual or abnormal activity has taken place, beyond what was associated with inventory production in the period, and which may have given rise to a future access benefit. As a result we considered whether the recognition principle included in the draft Interpretation needed to include a type of trigger, which would alert the entity to the fact that something additional to inventory production has occurred. Such a trigger may be any of the items stated in (draft Interpretation) paragraph 18 (a) – (c) above, it may be a type of profit trigger.

10. We decided that the fact that the entity would apply the asset recognition criteria as set out in paragraphs 8 – 15 of the draft Interpretation to identify whether a future benefit had been created would be sufficient, and that no recognition trigger was needed.

Question for the Committee
3. Does the Committee think that we need to include consideration of a trigger event in the recognition principles of the draft Interpretation, or does the Committee agree that the asset recognition principles, as stated, are sufficient?