IFRS in Focus

IFRS Interpretations Committee issues Draft Interpretation on Stripping Costs in the Production Phase of a Surface Mine

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The Bottom Line

- Costs of a stripping campaign incurred during the production phase would be capitalised as a component of an existing asset, whereas routine stripping costs would be expensed.
- The stripping campaign component would be classified according to the nature of the existing asset to which it relates.
- Stripping campaign costs would initially be measured at cost and subsequently carried at cost less depreciation or amortisation and impairment.
- The proposals would be applied prospectively from the date of adoption, with any existing stripping cost assets being reclassified as a component of the asset to which it relates.
- The comment period ends on 30 November 2010.

The proposal

On 26 August 2010, the International Financial Reporting Standards Interpretations Committee ("the Interpretations Committee") published draft Interpretation DI/2010/1 *Stripping Costs in the Production Phase of a Surface Mine* ("the draft Interpretation"). The draft Interpretation was developed in response to a request for guidance on accounting for waste removal costs incurred in the production phase of a surface mine.

In surface mining operations, entities may find it necessary to remove waste materials to access mineral ore deposits. During the development phase of the mine, stripping costs are usually capitalised as part of the cost of constructing the mine and depreciated over the life of the mine once production begins. However, it may be necessary to continue removing waste materials during the production phase to gain access to a specific section of the ore body. This process is referred to as the "stripping campaign".

The draft 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." It further states that "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 with which the campaign is associated."

The draft Interpretation addresses the following issues:

- whether the definition of an asset is met;
- when the stripping campaign component should be recognised; and
- how the stripping campaign component should be measured at initial recognition and subsequently.

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www.iasplus.com

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Definition of an asset

The draft Interpretation states that the stripping activity would create a benefit in the form of improved access to the ore to be mined, which would qualify for recognition as a component of an existing asset when:

- ”an entity controls the benefit created by the stripping activity, by either owning the land that it is mining, or owning the rights to mine the land;
- the benefit arises as a result of stripping activity, and consequently 'as a result of past events'; and
- a future economic benefit will flow to an entity through the improved access to the ore that is expected to be economically recoverable in the future.”

The draft Interpretation further proposes that the costs of a stripping campaign should be accounted for as an addition to, or an enhancement of, an existing asset and classified as tangible or intangible according to the nature of the existing asset to which it relates. Routine stripping costs that are not incurred as part of a stripping campaign should be accounted for as current costs of production in accordance with IAS 2 *Inventories*.

Recognition of a stripping campaign

It is proposed that the stripping campaign component is recognised when the stripping activity takes place and the costs of creating the stripping campaign component are incurred. An entity would cease recognition of the costs of the stripping campaign component upon completion of the waste removal activity necessary to access the ore with which the campaign is associated.

Measurement of a stripping campaign

The draft Interpretation proposes that the stripping campaign component should initially be measured at cost, being the “accumulation of costs directly incurred to perform the stripping activity and an allocation of directly attributable costs”. Costs associated with incidental operations would not be included in the cost of the stripping campaign component. After initial recognition, the stripping campaign component would be carried at its cost less depreciation or amortisation, and less any impairment losses.

Observation

There is diversity in practice in accounting for stripping costs, with some entities recognising all stripping costs as production costs, while others capitalise stripping costs using approaches such as the 'life-of-mine ratio' or other similar approaches. The proposals would result in a significant change in practice for these entities and would require the identification of costs incurred to gain access to a specific section of mineral ore. Entities may need to make changes to existing systems in order to track separately the waste removal costs between the various sections of mineral ore to be accessed.

The proposals require the depreciation or amortisation to be recognised on a rational and systematic manner, over the expected useful life of the specific section of the ore body that becomes directly accessible as a result of the stripping campaign. The draft Interpretation proposes the application of the units of production method unless another method is deemed more appropriate.

The stripping campaign component would be assessed for impairment in accordance with IAS 36 *Impairment of Assets*. The draft Interpretation lists the suspension (or planned suspension) of the extraction of the ore that is specifically associated with the stripping campaign component as an indicator of impairment.

Transition

The draft Interpretation would be applied to production stripping costs incurred on or after the beginning of the earliest period presented. Accordingly, existing stripping cost assets as at the date of transition would be reclassified as a component of the asset to which the stripping activity relates. These balances should be depreciated or amortised over the expected useful life of the specific section of the ore body to which each stripping campaign component relates. When it is not possible to identify any remaining ore with which the stripping component can be directly associated, it should be recognised in profit or loss at the beginning of the earliest period presented. Any existing stripping cost liability balances should be recognised in profit or loss at the beginning of the earliest period presented.

Observation

As entities would be required to apply the Interpretation only prospectively, the proposed transition requirements would result in the "grandfathering" of stripping cost assets recognised using the 'life-of-mine strip ratio' approach, by reclassifying these balances as components of existing assets and depreciating them as those associated assets are mined.

Effective date

The comment period ends on 30 November 2010. The draft Interpretation does not specify an effective date. The Interpretations Committee will determine the effective date after considering the comments they receive on the draft Interpretation.

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