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Straight away

IFRS bulletin from PricewaterhouseCoopers

The IFRIC publishes Draft Interpretation on 'Stripping Costs in the Production Phase of a Surface Mine'

What is the issue?

The IFRIC has published a Draft Interpretation (DI) on stripping costs that may have significant day one impacts for IFRS mining companies. The interpretation sets out guidance on the accounting for waste removal (stripping) costs in the production phase of a mine. The challenge in accounting for stripping costs in the production phase is identifying and allocating the benefits and the costs of stripping activity across different reporting periods. There is some diversity in practice as there is no specific guidance under IFRS. Some entities expense stripping costs as a cost of production and some entities capitalise some or all stripping costs on different calculation bases (e.g. life-of-mine ratio).

The transition provisions of the DI may have significant impacts when adopted; it will apply to all stripping campaigns in progress and require existing stripping cost balances to be reclassified and associated with specific ore quantities. Balances that cannot be associated with specific ore bodies will be written off to profit and loss on adoption.

The DI applies only to stripping costs that are incurred in surface mining activity during the production phase of the mine.

The DI addresses the following issues:

1. Is the definition of an asset met?

The stripping activity creates a benefit of improved access to the ore to be mined for the entity. An entity should assess if the benefits meet the definition of an asset as set out in the IFRS Framework. The benefit of improved access to the ore will qualify as an asset when:

a) An entity controls the benefit created by the stripping activity by either owning the land which it is mining or owning the rights to mine the land;
b) The benefit arises as a result of stripping activity, therefore „as a result of past events, and
c) A future economic benefit will flow to an entity through improved access to the ore that is expected to be economically recoverable in the future.

Routine stripping costs that are not part of a stripping campaign should be accounted for as current production cost in accordance with IAS 2. Stripping costs that are part of a stripping campaign should be accounted for as an addition to or enhancement of an existing asset (stripping campaign component). The asset is classified as tangible or intangible, according to the nature of the existing asset.

The stripping campaign component should be specifically associated with the section of ore that becomes more directly accessible as a result of the stripping activity. The DI proposes this “specific association” approach in preference to the “Strip ratio” approach which is currently used by many in the industry.

2. When should the asset be recognised?

The DI proposes that the stripping campaign component should be recognised as the stripping activity takes place and the costs of creating that asset are incurred.

3. How should the asset be measured initially?

The stripping campaign component should be measured initially at cost. The costs should be directly incurred to perform the stripping activity (e.g. haulage, waste transportation, materials consumed, costs of machinery employed, labour and fuel). Ancillary activities associated with these operations should not be included in the cost of the stripping campaign component.

4. How should the asset be measured subsequently?

The stripping campaign component should be carried at cost less depreciation or amortisation and impairment charges. It should be depreciated or amortised in a rational and systematic manner over the useful life of the ore body that becomes accessible as a result of the stripping campaign. The units-of-production method is applied unless another method is more appropriate.

The stripping campaign component is tested for impairment under IAS 36. Suspension or planned suspension of mining activity for the ore specifically associated with the stripping campaign component would be an indicator of impairment.

Am I affected?

All surface mining companies applying IFRS would be affected by the DI. Early application of the DI would be permitted. The DI is proposed to apply to all ongoing stripping campaigns as of the effective date. Any existing stripping cost asset balances at the date of transition should be reclassified as a component of the mine asset to which the stripping activity related and then depreciated/amortised over the related specific ore quantity. A component that cannot be associated with specific identifiable ore, and any stripping cost liability balances, should be written off to profit or loss at the beginning of the earliest period presented. This could have a significant impact on results in the initial year of adoption. Entities would also have to assess whether processes exist to implement the “specific association” approach described in the DI.

What do I need to do?

The IFRIC is requesting comments on the DI by 30 November 2010. Management should consider commenting on the proposals. Existing IFRS preparers may be most interested in the proposed transition provisions in the interpretation.

If you have questions about this issue, please contact PwC IFRS team.

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