

Financial INSIGHT

November 2011

IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*

Introduction

In our last Financial INSIGHT: 'IFRIC Update' issued in September 2011, we discussed the ongoing deliberations of the International Financial Reporting Standards Interpretations Committee ("IFRIC") with regard to their draft Interpretation. On 19 October 2011, IFRIC finally issued IFRIC Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine* ("IFRIC 20").

IFRIC 20 clarifies the requirements for accounting for stripping costs in the production phase of a surface mine, such as when such costs can be recognised as an asset and how that asset should be measured, both initially and subsequently.

IFRIC 20 only deals with waste removal costs that are incurred in surface mining activity during the production phase of the mine ("production stripping costs"). During the development phase, 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.

This Financial INSIGHT provides an overview and explains the key concepts of this new Interpretation.

Overview of IFRIC 20

1. Key Concepts

Recognition of production stripping costs as an asset

In surface mining operations, the removal of mine waste materials to gain access to mineral ore deposits is known as 'stripping'. In the production phase, the materials removed will include both waste and ore deposits. This presents a challenge for accounting for costs incurred in this process as they may benefit both future and current period production.

In the production phase two benefits can accrue to the entity from stripping activity being:

- a) Ore that can be used to produce inventory; and
- b) Improved access to or for future mining.

IFRIC 20 deals with when and how to account separately for these two benefits.

Where the benefit is realised in the form of inventory produced, the costs of the stripping activity are accounted for in accordance with IAS 2 *Inventories*.

Where the benefit is realised in the form of improved access to ore deposits, the stripping costs are recognised as a non-current asset ("stripping activity asset"), if all the following criteria are met:

1. It is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;
2. The entity can identify the component of the ore body for which access has been improved; and
3. The costs relating to the stripping activity associated with that component can be measured reliably.

IFRIC 20 requires the stripping activity asset to be accounted for as an addition to, or as an enhancement of, an existing asset, rather than being an asset in its own right. The asset is to be classified as tangible or intangible consistent with how that existing asset is classified.

Initial measurement of the stripping activity asset

The stripping activity asset is initially measured at cost, being costs directly incurred in the stripping activity, such as materials, transport and labour plus an allocation of directly attributable overhead costs, such as an allocation of mine supervisor salary and rental costs of hired equipment.

In practice, it may be difficult to measure the separate cost of inventory produced at the same time as the stripping activity asset is created. Accordingly, IFRIC 20 requires costs to be allocated using a relevant production measure as a basis.

This production measure is calculated for the identified component of the ore body, and used as a benchmark to identify the extent to which the additional activity of creating a future benefit has taken place.

The Basis for Conclusions to IFRIC 20 notes that the production measure is considered as a good indicator of the nature of the benefits that are generated for the activity taking place in the mine. The production measure basis requires an entity to identify when 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.

Examples of such measures include:

- Costs of inventory produced compared with expected cost;
- Volume of waste extracted compared with expected volume, for a given volume of ore production; and
- Mineral content of the ore extracted compared with expected mineral content to be extracted, for a given quantity of ore produced.

Subsequent measurement of a stripping activity asset

After initial recognition, the stripping activity asset is carried at either its cost or its revalued amount less depreciation or amortisation and less impairment losses, consistent with the existing asset of which it is a part.

The asset is 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 should be applied unless another method is more appropriate.

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 mine itself and related life-of-mine assets unless the activity improves access to the whole of the remaining ore body. This might occur towards the end of a mine's useful life when the identified component represents the final part of the ore body to be extracted.

2. Effective date

IFRIC 20 applies to annual reporting periods beginning on or after 1 January 2013, with early adoption permitted.

3. Transitional provisions

IFRIC 20 is required to be applied to production stripping costs incurred on or after the beginning of the earliest period presented. Existing asset balances that resulted from stripping activity as at the date of transition will be reclassified as part of an existing asset to which the stripping activity relates, to the extent there remains an identifiable component of the ore body with which the existing stripping asset can be associated. These balances will then be depreciated or amortised over the remaining expected useful life of the identified component of the ore body.

When there is no identifiable component of the ore body to which that existing asset balance relates, it should be recognised in opening retained earnings at the beginning of the earliest period presented.

4. Actions

All surface mining entities that apply IFRS will be affected by this Interpretation and, accordingly will need to carefully consider the effect of applying IFRIC 20 as soon as possible in light of the transitional provisions.

If you wish to discuss any of the issues raised in this publication contact your local RSM Bird Cameron advisor.



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