

August 2010

Draft IFRIC Interpretation DI/2010/1

# Stripping Costs in the Production Phase of a Surface Mine

Comments to be received by 30 November 2010

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## INVITATION TO COMMENT

The International Accounting Standards Board's IFRS Interpretations Committee invites comments on any aspect of this draft Interpretation *Stripping Costs in the Production Phase of a Surface Mine*. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **30 November 2010**.

### **Question 1 – Definition of a stripping campaign**

The proposed 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. 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 to which the campaign is associated.

Do you agree that the proposed definition satisfactorily distinguishes between a stripping campaign and routine waste clearing activities? If not, why?

### **Question 2 – Allocation to the specific section of the ore body**

The proposed Interpretation specifies that the accumulated costs recognised as a stripping campaign component shall be depreciated or amortised in a rational and systematic manner, over the specific section of the ore body that becomes directly accessible as a result of the stripping campaign. The units of production method is applied unless another method is more appropriate.

- (a) Do you agree with the proposal to require the stripping campaign component to be depreciated or amortised over the specific section of the ore body that becomes accessible as a result of the stripping campaign? If not, why?
- (b) Do you agree with the proposal to require the units of production method for depreciation or amortisation unless another method is more appropriate? If not, why not?

### **Question 3 – Disclosures**

The proposed Interpretation will require the stripping campaign component to be accounted for as an addition to, or an enhancement of, an existing asset. The stripping campaign component will therefore be required to comply with the disclosure requirements of that existing asset.

Is the requirement to provide disclosures required for the existing asset sufficient? If not, why not, and what additional specific disclosures do you propose and why?

### **Question 4 – Transition**

Entities would be required to apply the proposed Interpretation to production stripping costs incurred on or after the beginning of the earliest comparative period.

- (a) Do you agree that this requirement is appropriate? If not, what do you propose and why?

The proposed Interpretation requires any existing stripping campaign component to be recognised in profit or loss, unless the component can be directly associated with an identifiable section of the ore body. The proposed Interpretation also requires any stripping cost liability balances to be recognised in profit or loss on transition.

- (b) Do you agree with the proposed treatment of existing stripping cost balances? If not, what do you propose and why?

# IFRS Interpretations Committee

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## [DRAFT] INTERPRETATION D1/2010/1

### ***Stripping Costs in the Production Phase of a Surface Mine***

[Draft] IFRIC X *Stripping Costs in the Production Phase of a Surface Mine* ([draft] IFRIC X) is set out in paragraphs 1–22 and the Appendix. [Draft] IFRIC X is accompanied by illustrative examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 2 and 7–17 of the *Preface to International Financial Reporting Standards*.

## References

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- *Framework for the Preparation and Presentation of Financial Statements*
- *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

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- 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 over the life of the mine 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. Stripping costs in the production phase may be part of the routine costs incurred during production. Production stripping costs may also be incurred as part of a systematic effort to gain access to a specific section of the ore body. This [draft] Interpretation refers to such a concentrated production stripping effort as a ‘stripping campaign’.
- 4 A stripping campaign is 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. 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.

## Scope

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

## Issues

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- 6 The [draft] Interpretation addresses the following issues:
- (a) Is the definition of an asset met?
  - (b) When should the stripping campaign component be recognised?
  - (c) How should the stripping campaign component be measured initially?
  - (d) How should the stripping campaign component be measured subsequently?

## Consensus

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### Is the definition of an asset met?

- 7 An entity creates a benefit by undertaking stripping activity (and incurring stripping costs). This benefit is improved access to the ore to be mined. An entity shall assess whether the benefit meets the definition of an asset set out in the *Framework*. Paragraph 49(a) of the *Framework* states that ‘an asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.’ The benefit of improved access to the ore will qualify for recognition as part of (a component of) an existing asset when:
- (a) 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;
  - (b) the benefit arises as a result of stripping activity, and consequently ‘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.

- 8 The costs of stripping activity that are part of a stripping campaign shall be accounted for as an addition to, or an enhancement of, an existing asset. In other words, this benefit will become a component of an existing asset, and is referred to in this [draft] Interpretation as the 'stripping campaign component'.
- 9 Routine stripping costs that are not incurred as part of a stripping campaign shall be accounted for as current costs of production in accordance with IAS 2.
- 10 An entity shall classify the stripping campaign component as tangible or intangible according to the nature of the existing asset to which it relates.
- 11 The stripping campaign component shall be specifically associated with the section of ore that becomes directly accessible as a result of the stripping activity.

### **When should the stripping campaign component be initially recognised?**

- 12 An entity shall recognise the stripping campaign component when the stripping activity takes place and the costs of creating the stripping campaign component are incurred.
- 13 Recognition of the stripping campaign component shall cease when the entity has completed the waste removal activity necessary to access the ore with which the campaign is associated.

### **How should the stripping campaign component be measured initially?**

- 14 The entity shall measure the stripping campaign component initially at cost, being the accumulation of costs directly incurred to perform the stripping activity and an allocation of directly attributable costs.
- 15 Some incidental operations may take place at the same time as the stripping activity, but are not necessary for the stripping campaign to continue as planned. The costs associated with these activities shall not be included in the cost of the stripping campaign component.

## How should the stripping campaign component be measured subsequently?

- 16 After initial recognition, the stripping campaign component shall be carried at its cost less depreciation or amortisation, and less any impairment losses.
- 17 The stripping campaign component shall be depreciated or amortised in 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 units of production method is applied unless another method is more appropriate.
- 18 The expected useful life of the specific section of the ore body used to depreciate or amortise the stripping campaign component may differ from that used to depreciate or amortise the mine and related life-of-mine assets, because the stripping campaign will give access only to a portion of the total ore body.
- 19 An entity should consider the stripping campaign component for impairment in accordance with IAS 36. Suspension (or planned suspension) of the extraction of the ore that is specifically associated with the stripping campaign component is an indication that the component may be impaired.

### **Effective date**

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- 20 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [draft] Interpretation for a period beginning before [date to be inserted after exposure], it shall disclose that fact.

### **Transition**

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- 21 An entity shall apply this [draft] Interpretation to production stripping costs incurred on or after the beginning of the earliest period presented.
- 22 Each existing stripping cost asset balance as at the date from which this [draft] Interpretation is applied, that resulted from stripping activity undertaken during the production phase shall be reclassified as a component of the asset to which the stripping activity relates. Such balances shall be depreciated or amortised over the expected useful life

of the specific section of the ore body to which each stripping campaign component relates. If there is no identifiable section of the ore body to which that component can be directly associated, it shall be recognised in profit or loss at the beginning of the earliest period presented. Any existing stripping cost liability balances shall be recognised in profit or loss at the beginning of the earliest period presented.

## Appendix

### [Draft] Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph D1 is amended as follows (new text is underlined and deleted text is struck through).

- D1 An entity may elect to use one or more of the following exemptions:
- (a) share-based payment transactions (paragraphs D2 and D3);
  - ...
  - (n) borrowing costs (paragraph D23);
  - (o) transfers of assets from customers (paragraph D24); ~~and~~
  - (p) extinguishing financial liabilities with equity instruments (paragraph D25); and
  - (q) stripping costs in the production phase of a surface mine (paragraph D26).

After paragraph D25 a heading and paragraph D26 are added.

#### **Stripping costs in the production phase of a surface mine**

- D26 A first-time adopter may apply the transitional provisions set out in paragraphs 21 and 22 of IFRIC X *Stripping Costs in the Production Phase of a Surface Mine*. In those paragraphs, reference to the effective date shall be interpreted as [date to be inserted after exposure] or the date of transition to IFRSs, whichever is later.

After paragraph 39F\* paragraph 39G is added.

- 39G IFRIC X *Stripping Costs in the Production Phase of a Surface Mine* added paragraph D26. An entity shall apply that amendment when it applies IFRIC X.

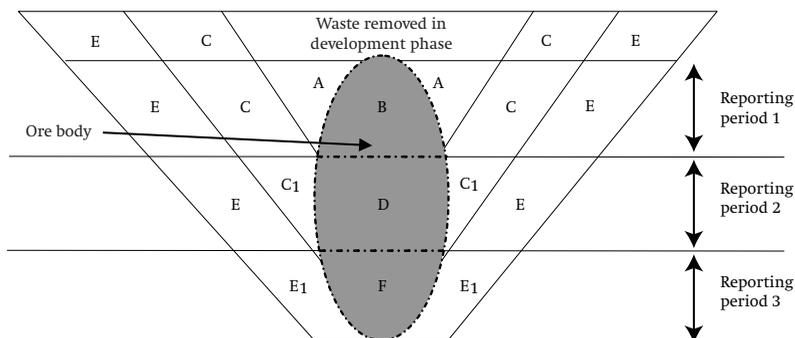
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\* Paragraph 39F is proposed in the exposure draft *Removal of Fixed Dates for First-time Adopters*.

## Illustrative examples

*These examples accompany, but are not part of, the [draft] Interpretation.*

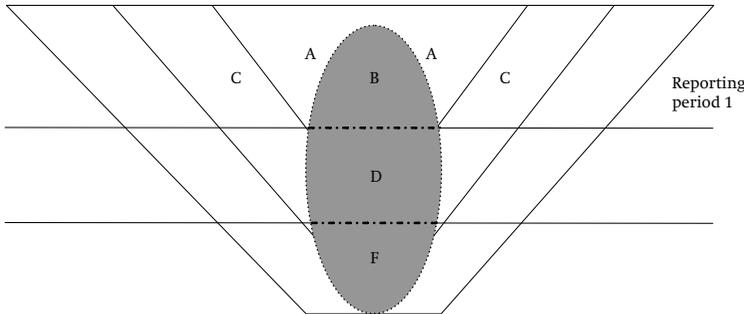
- IE1 The following diagram and related explanation is provided in order to illustrate the difference between a stripping campaign and routine stripping activities, and also to clarify the concept of specific identification of a section of the ore body for the purposes of depreciation or amortisation.



- IE2 Assume reporting periods 1, 2 and 3 all take place in the production phase of the mine. Assume that the production phase of the mine ends at the end of reporting period 3. Assume also that the total ore body is represented by areas B + D + F.

## Reporting period 1

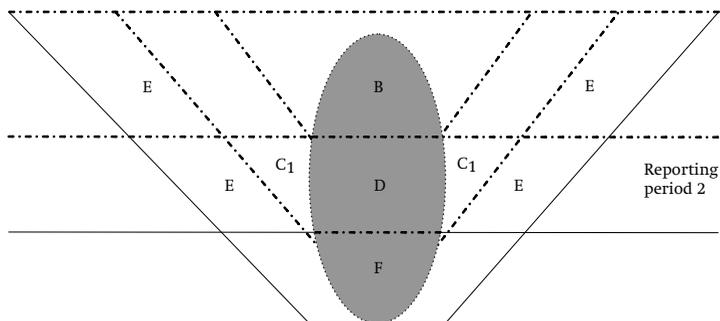
IE3 The diagram below is a modification of the diagram in paragraph IE1 above—it shows only the areas that are relevant to reporting period 1.



- IE4 Routine stripping activity takes place in area A, in order to gain access to the ore body in area B. The costs incurred in clearing area A are considered to be routine stripping costs. The ore in B will be extracted in reporting period 1, therefore the costs of clearing A have no enduring benefit beyond the end of reporting period 1. These costs will be accounted for as current costs of production.
- IE5 Areas C represent a stripping campaign undertaken in reporting period 1 in order to gain access to the section of the ore body in area D. The section of the ore body in area D is not going to be extracted until reporting period 2. The costs relating to this stripping campaign are recognised as a stripping campaign component in reporting period 1, when incurred.

## Reporting period 2

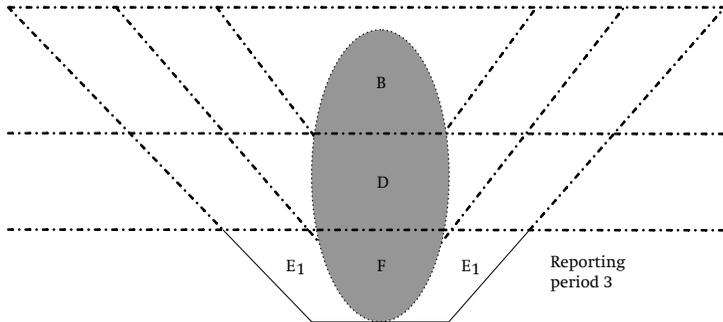
- IE6 The diagram below is a modification of the diagram in paragraph IE1—it shows only the areas that are relevant to reporting period 2.



- IE7 In reporting period 2, all of the section of the ore body in area D is extracted. The stripping cost component recognised in reporting period 1 is fully depreciated or amortised in reporting period 2, as the section of the ore body for which that stripping cost was incurred to gain access to it (area D) is extracted.
- IE8 The costs incurred in clearing area  $C_1$  are considered to be routine stripping costs. The ore in D will be extracted in reporting period 2, therefore the costs of clearing  $C_1$  have no enduring benefit beyond the end of reporting period 2. These costs will be accounted for as current costs of production.
- IE9 Areas E represent a stripping campaign undertaken in reporting period 2, in order to gain access to the section of the ore body in area F. The ore in area F is not going to be extracted until period 3. The costs relating to this stripping campaign are recognised as a stripping campaign component in reporting period 2.

### Reporting period 3

IE10 The diagram below is a modification of the diagram in paragraph IE1—it shows only the areas that are relevant to reporting period 3.



- IE11 In reporting period 3, all of the ore in area F is extracted. The stripping cost component recognised in reporting period 2 will be fully depreciated/amortised in reporting period 3, as the section of the ore body for which that stripping cost was incurred to gain access to it (area F) is extracted.
- IE12 Also during reporting period 3, the costs incurred in clearing areas E<sub>1</sub> are considered to be routine stripping costs. The ore in F will be extracted in reporting period 3, therefore the costs of clearing E<sub>1</sub> have no enduring benefit beyond the end of reporting period 3. These costs will be accounted for as current costs of production.
- IE13 No further stripping campaigns are undertaken in reporting period 3.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the draft Interpretation.*

### Introduction

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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

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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 such costs 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 a draft Interpretation in response to that divergence in practice.

BC4 The Committee decided to include the concept of the stripping campaign as the unit of account in the draft Interpretation. In practice, the deposit of ore in an open pit mine is usually exposed in a series of 'push-backs', where waste is stripped and the ore is mined in a phased manner. Mine planning will identify the number, extent and timing of push-backs required over the life of the mine.

BC5 The number, timing and extent of the stripping campaigns will depend upon a number of factors, eg maximising the productivity of the capital equipment and labour force, safety factors such as slope stability, characteristics of the ore body and scheduling of production to meet demand.

## Scope

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- BC6 The draft Interpretation proposes guidance on the accounting for stripping costs incurred in surface mining activity. In developing the draft 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.
- BC7 The Committee decided not to include stripping costs incurred during the development phase of the mine, because the Committee became aware that there is not significant diversity in practice in this regard.

## Consensus

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### Is the definition of an asset met?

- BC8 The Committee decided that, by incurring costs to remove waste, an entity may create a benefit, namely improved access to the mineral ore body. An ore body that has been cleared of waste is more valuable to an entity than one where less or no waste has been removed. Access to the ore body therefore becomes easier and less costly.
- BC9 Where the access benefit created by the stripping activity meets the definition of an asset, the Committee decided that the benefit created was more akin to an addition to, or improvement of, an existing asset, than an asset in its own right. Practically, the benefit 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.
- BC10 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 asset to which the benefit relates.
- BC11 The Committee decided that there is a difference between stripping activity that is ‘routine’, and stripping activity that takes the form of a systematic process to gain access to a specific section of the ore body—the latter is referred to in the draft Interpretation as a ‘stripping campaign’.

## **Routine stripping**

- BC12 Most surface mining operations will undertake routine stripping activity continuously just ahead of, or around, the ore currently being mined, to ensure that production continues without delay. The benefit created by routine stripping is unlikely to extend beyond the current reporting period, because the ore being uncovered as a result is likely to be mined in the current reporting period, and no potential future benefit to the entity exists. Routine stripping costs should therefore be accounted for as current costs of production.
- BC13 There will be some circumstances when routine stripping may create a benefit that will be realised in a future period. This may arise, for example, when stripping is performed continuously as part of routine operations, and continues into the following reporting period. The Committee decided that the costs of such routine stripping should not be recognised as part of an asset.

## **Stripping campaign**

- BC14 By nature, a stripping campaign will involve a significant ‘push-back’ or removal of waste material in order to widen or deepen an existing pit, or to create a new, satellite pit. This activity is likely to have an enduring benefit—the area that has been accessed as a result may be mined over a number of future periods—and consequently, the recognition criteria for an asset will usually be met.
- BC15 Distinguishing a stripping campaign from routine stripping activities will require judgement. The Committee believes, however, that entities generally plan for stripping campaigns well in advance and that such campaigns are typically well enough defined by an entity’s mine plan for the determination, in practice, of whether particular activities are part of routine stripping or a stripping campaign, to be made with reasonable consistency.
- BC16 At the same time as the component is recognised, it is important that the entity should link the costs incurred to the section of the ore body that will be accessed as a result of the stripping campaign. This specific identification approach links the stripping activity to the benefit created, and is crucial to the subsequent depreciation or amortisation of the asset, which will take place as the ore is mined.

## **When should the stripping campaign component be recognised?**

- BC17 The stripping campaign component is an accumulation of costs incurred, as a result of stripping activity, that meet asset recognition criteria (paragraph 49(a) of the *Framework*). Consequently, the component is recognised as the stripping activity takes place.
- BC18 The stripping campaign is in effect a subset of the total life of the mine. A mine may have one or more stripping campaigns planned into the production phase.
- BC19 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 campaign component should end. Paragraph 20 of IAS 16 states that recognition should 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 section of land is stripped to the extent required in order to achieve this objective, recognition of stripping costs relating to that section of land should cease. Subsequent stripping costs should be separately assessed to determine whether they represent routine stripping, or a new stripping campaign.

## **How should the stripping campaign component be measured initially?**

- BC20 The Committee decided to follow the principle in paragraph 21 of IAS 16 to determine whether incidental costs should be included in the measurement of the stripping campaign component. It is likely in practice that other development activities will take place at the same time and in the same area as the stripping activity, but not be of a waste-removal nature. The Committee was concerned that the costs relating to these ancillary activities would also be capitalised to the stripping campaign component. The Committee therefore decided that ancillary costs should not be capitalised as part of the stripping campaign component.

## **How should the stripping campaign component be measured subsequently?**

- BC21 The Committee decided that the most rational and systematic way of depreciating or amortising the cost of the stripping campaign component would be over the expected useful life of the section of the ore body that benefited from the campaign. This is an application of the units of production method that is commonly used, but is focused only on the section of the ore body that is directly accessed through the stripping campaign. Because the life of the stripping campaign is usually a subset of the entire life of the mine, the stripping campaign component will be depreciated or amortised over a lesser period than the life of the mine. It is not expected that a stripping campaign would last the duration of the entire mine.

### **Transition**

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- BC22 Because of the complex and lengthy nature of many mining operations, and the 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 in doing so. The Committee therefore decided that the proposed Interpretation should require prospective application to production stripping costs incurred on or after the beginning of the earliest period presented.
- BC23 The Committee also decided that any existing stripping costs asset balances should each be reclassified as components of existing assets, and depreciated or amortised as the specific ore to which those asset balances are associated is mined. If it is not possible to identify any remaining ore to be mined for those stripping costs asset balances, the amounts should be recognised in profit or loss at the date of application of the proposed Interpretation. Any existing stripping cost liability balances should be recognised in profit or loss at the beginning of the earliest period presented.