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IN THE HEADLINES
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Changes in accounting for production stripping costs likely

In response to diversity in the accounting for production stripping costs incurred in surface mining activity, the IASB has issued an Interpretation that introduces requirements related to capitalisation and recognition in profit or loss. In our experience, only a handful of mining companies will be able to conclude that their current accounting is completely in line with the Interpretation.

IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* was issued on 19 October 2011 and will be applicable for years beginning on or after 1 January 2013, with early adoption permitted.

Capitalisation of production stripping costs required if certain criteria are met

The Interpretation requires production stripping costs in a surface mine to be capitalised if certain criteria are met. This is because there may be two benefits to stripping activity:

- current period production; and
- improved access to ore for future production.

To the extent that benefits are realised in the form of inventory produced, the related production stripping costs are accounted for in accordance with IAS 2 *Inventories*.

Production stripping costs that improve access to ore to be mined in the future are recognised as a non-current asset if, and only if, all of the following criteria are met:

- it is probable that the future economic benefit will flow to the entity;
- the entity can identify the component of the ore body for which access has been improved; and
- the costs relating to the stripping activity associated with that component can be measured reliably.

The stripping activity asset is recognised and accounted for as a component of the mining assets to which it relates.

Highlights

- Surface mining companies will capitalise production stripping costs that benefit future periods, if certain criteria are met
- Capitalisation, and the depreciation period, will depend on the identified component of the ore body to which the stripping activity relates
- Any allocation of costs between inventory and the stripping activity asset will be based on a production measure
- In our experience, only a handful of mining companies will be able to conclude that their current accounting is completely in line with the Interpretation
- The Interpretation applies prospectively, and is applicable for years beginning on or after 1 January 2013

Our forthcoming publication *First Impressions: Production stripping costs* will provide more details about the requirements and discuss some of the potential application issues. Speak to your usual KPMG contact if you would like copies.

Identification of a component of the ore body is key to the accounting

As seen above in the criteria for capitalisation, the identification of a component of the ore body will drive the accounting. Additionally, the life of the component will determine the period of depreciation for capitalised costs; it will differ from the life of the mine unless the stripping activity improves access to the whole of the remaining ore body. Overall, identification of the relevant component of the ore body is likely to require judgement, particularly when multiple stripping campaigns are undertaken for one ore body.

Allocation between inventory and stripping activity asset based on a production measure

When the costs of the stripping activity asset vs inventory produced are not separately identifiable, the entity allocates production stripping costs between the two based on a 'relevant' production measure. The examples of such measures given in the Interpretation are:

- actual vs expected cost of inventory produced;
- actual vs expected volume of waste extracted; and
- actual vs expected mineral content of ore extracted.

Most surface mining companies likely to be affected

Currently accounting practice is mixed. A review that we performed of the most recent financial statements of 26 mining companies revealed that just over half (15) disclosed their accounting policy for production stripping costs. Of these 15 companies, just over a third expensed such costs as incurred for some or all of their mines. This means not only a change in accounting policy for these companies, but a need to look at the processes required to capture the relevant data at the mine level.

However, this does not mean that companies already deferring production stripping costs can continue as they were under the new requirements. Firstly, the Interpretation specifies the costs to be capitalised, which may differ from current practice in some cases. Secondly, it requires companies to ensure that those costs are recognised in profit or loss over a period that in some cases may well be shorter than the period currently used. All in all, we think that only a handful of mining companies will be able to conclude that their current accounting is completely in line with the Interpretation.

Prospective application on transition

The Interpretation applies prospectively to production stripping costs incurred on or after the beginning of the earliest period presented. On transition, companies with existing asset balances relating to stripping activity may have two forms of adjustment.

- Existing balances relating to stripping activity that are not related to an identifiable component of the ore body will be written off. The adjustment will be recognised in opening retained earnings at the beginning of the earliest period presented.
- Any remaining asset balance relating to production stripping will be reclassified as part of an existing asset to which the stripping activity related. Such balances will be depreciated over the remaining expected useful life of the identified component of the ore body to which they relate.

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