

DRAFT COMMENT LETTER
Comments should be submitted by 19 November 2010 to
[**Commentletters@efrag.org**](mailto:Commentletters@efrag.org)

XX October 2010
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re Draft IFRIC Interpretation *Stripping Cost in the Production Phase of a Surface Mine*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Draft IFRIC Interpretation *Stripping Cost in the Production Phase of a Surface Mine* (the DI). This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the definitive interpretation in the European Union and European Economic Area.

EFRAG is aware of diversity in practice relating to the treatment of production stripping cost. We realise that this diversity does not only relate to the assessment of whether stripping costs meet the definition of an asset and its classification as either inventory, property, plant and equipment or an intangible asset, but it extends to the measurement of these items and the existence of items such as stripping cost liabilities.

EFRAG therefore supports the Interpretations Committee in their efforts to resolve this diversity in practice. However, we do not believe that this DI appropriately achieves this.

We believe the proposals complicate the accounting for stripping costs by requiring three divergent treatments – pre-production stripping costs, routine stripping costs and other production stripping costs. This results in an approach that is cumbersome and internally inconsistent. It results in differences between in the recognition, measurement and disclosure requirements that apply to each category of stripping costs, which puts additional stress on the need to classify stripping costs properly.

EFRAG believes that the Committee should consider requiring application of the accounting model in IAS 16 to all forms of stripping costs. We believe that this would avoid introducing unnecessary complexity in IFRS and reduce the risk of unintended consequences (e.g. the DI leaves accounting for changes in restoration provisions related to stripping costs unaddressed). Our detailed comments on the DI are set out in Appendix 1 to this letter.

If you wish to discuss our comments further, please do not hesitate to contact Marius van Reenen or me.

Yours sincerely

Françoise Flores
EFRAG, Chairman

APPENDIX 1

EFRAG's responses to the questions asked in the xxx

Notes to EFRAG constituents

- 1 *In mining operations, entities usually employ two methods to access ore deposits: surface mining or underground mining. In surface mining, entities will have to remove waste materials (referred to as 'overburden') in order to access the mineral deposits they aim to extract. This is referred to as 'stripping'. This DI applies to surface mining only, and does not apply to similar activities in the oil and gas industry such as tar sand operations.*
- 2 *Overburden is removed during the development and the production phase. The DI is concerned with stripping costs during the production phase because this is where the accounting diversity exists. That is, some entities expense these costs whereas others recognise them as assets under various accounting methods. Pre-production stripping costs, however, are usually capitalised as part of the cost of developing the mine.*
- 3 *Paragraph 7 of the DI states that 'an entity creates a benefit by undertaking stripping activity' because it improves the access to the ore to be mined. Hence, the stripping activity leads to greater future economic benefits. The DI further states that the benefit that is created will qualify for recognition as part of a component of an existing asset when:*
 - (a) *an entity controls the benefit creates 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 (i.e. the past event); and*
 - (c) *future economic benefits will flow to an entity through improved access to the ore that is expected to be economically recoverable in the future.*
- 4 *Stripping costs should be accounted for as an addition to, or an enhancement of, an existing asset (referred to as a 'stripping campaign component') as long as those costs can be associated with the creation of future economic benefits. The already existing asset, according to paragraph BC9 of the DI, could be the mine property, the mineral deposit itself, the development asset or the right to extract.*

General comments

- 5 We note that the DI specifies the treatment in surface mining of three categories of stripping cost to which three different standards are applied:
 - (a) Pre-production stripping costs are treated as a 'cost of building, developing and constructing the mine'. This category is assumed to be treated as property, plant and equipment under IAS 16 *Property, Plant and Equipment*, although we understand that some entities apply IAS 38 *Intangible Assets*;
 - (b) Routine stripping costs are treated as a cost of production under IAS 2 *Inventory*, while

- (c) Other production stripping costs (i.e. those incurred during the production phase that are not routine) are treated as an asset under the newly proposed accounting model in the DI.
- 6 In EFRAG's view, this will not resolve the diversity in practice. While entities might recognise and measure assets similarly (and we are not convinced that this DI would achieve such comparability), the presentation and disclosure of those assets would not be comparable because of the different requirements of IAS 16 and IAS 38.
- 7 We urge the Committee to resolve this issue within this interpretation. In our view capitalised stripping cost should be treated (like pre-production stripping cost) as a cost of developing the mine. We see waste stripping as similar to leasehold improvements, which, although they add value to a lease, are treated in accordance with IAS 16. This would also be in line with paragraph 25(b) of the Exposure Draft *Leases*, which states that a 'lessee shall present ... right-of-use assets as if they were tangible assets within property, plant and equipment...'.
- 8 We agree that the provisions of IAS 36 *Impairment of Assets* are applicable. However, the second sentence in paragraph 19 of the DI appears to propose an additional impairment indicator to IAS 36, and assumes that the stripping campaign asset will be tested individually for impairment rather than as part of a cash-generating unit in accordance with IAS 36. We assume that this is unintentional and suggest that it be deleted.
- 9 We also suggest that the Illustrative Examples be deleted from the final interpretation. We believe that defining the terms 'stripping campaign' and 'routine stripping' by example, without considering the full range of surface mining techniques used in the mining industry, is likely to lead to diversity in practice.

Question 1— Definition of a stripping campaign

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

Notes to EFRAG constituents

- 10 *The DI defines a stripping campaign as a 'systematic process undertaken to gain access to a specified section of the ore'. In other words, it relates to a process of removing waste ore in order to gain access to a designated section of a larger identified ore body.*
- 11 *The DI also distinguishes between 'routine waste' removal (i.e. waste removal that does not create benefit into the next reporting period) and a stripping campaign as the latter being a process that is more aggressive and concentrated in nature than a routine one.*
- 12 *A stripping campaign usually forms part of an entity's mine plan (i.e. how the entity plans to get to and extract the ore). Such a stripping campaign is planned with a defined start date that will end once the waste has been removed in order to access the ore to the specified section of the ore body.*

EFRAG does not believe that the proposed definition is appropriate.

- 13 EFRAG does not believe that the proposed definition is appropriate. Our primary concern is the reference to a ‘more aggressive process than routine waste clearing activities’. We do not find this wording clear because:
- (a) It defines the stripping campaign by reference to another undefined term being ‘routine waste clearing activities’; and
 - (b) We do not understand when one would consider certain stripping activities to be more aggressive than routine stripping activities.
- 14 In addition, we do not believe that the reference to a ‘specific section of the ore’ is helpful. In fact, it would appear that in the case of dispersed deposits – where it may be increasingly difficult to allocate stripping activities to a specific ore section – the stripping costs might never be considered part of a stripping campaign. We believe that application of this definition could be highly subjective in practice.
- 15 If these proposals in the DI were to be taken further, EFRAG believes that the final interpretation should distinguish between routine stripping and a stripping campaign based on whether the costs incurred relate to the ore currently being extracted or to ore that will be extracted in the future, respectively. The latter forms part of the further construction of the mine and should be treated as a tangible asset in accordance with IAS 16.

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

- (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?

Notes to EFRAG’s constituents

- 16 *The stripping campaign component will be specifically associated with the section of the ore body that becomes directly accessible due to the efforts of the stripping activity.*

Initial recognition

- 17 *The stripping campaign component should be recognised when the stripping activity takes place. The entity should cease the recognition of the stripping campaign component when the waste removal activity that is necessary to access that specific section of the ore body has completed.*
- 18 *The entity should measure the stripping campaign component initially at cost that consists of the costs that relate directly to the stripping activity and an allocation of directly attributable costs (it is assumed that the determination of what is considered to be directly attributable depends on whether an entity applies IAS 16 or IAS 38 to the already existing asset). Costs that are considered to be incidental costs (i.e. costs that are not related to waste removal) should not be included in the stripping campaign component.*

Measurement after recognition

- 19 *The stripping campaign component should be carried at cost less depreciation and impairment losses. The stripping campaign component should be depreciated using a rational and systematic approach, over the expected useful life of the ore body that has been directly attributable to the stripping campaign component and not the entire ore body. The DI states that the units-of-production method is applied unless another method is deemed appropriate.*
- 20 *An entity also considers whether the stripping campaign component is impaired in accordance with IAS 36: Impairment of Assets. It is further stated that suspension (or planned suspension) of the extraction of ore that is specific to the stripping campaign component is an indication that the component may be impaired.*

EFRAG disagrees with the proposals to allocate stripping cost to only a specific section of the ore body. Rather, we believe that stripping costs are best accounted for under IAS 16.

- 21 As mentioned above, EFRAG disagrees with the proposals. In our view, the stripping asset should be amortised or depreciated as part of the tangible mining asset to which it relates and that the provisions of IAS 16 should apply. Therefore, we do not believe that the restriction proposed is appropriate and rather that judgement is required to determine the extent of the benefit created by the stripping activity while applying IAS 16.
- 22 We agree that the unit-of-production method should apply unless another method is more appropriate in accordance with paragraphs 60 to 62 of IAS 16.

Question 3 – Disclosures

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?

- 23 *The stripping campaign component is treated as an enhancement or an addition to an already existing asset (i.e. the development mine). Hence, the stripping campaign component will be required to comply with the disclosure requirements of that existing asset.*
- 24 *In practice, entities either account for the already existing asset as either a tangible or intangible asset. Therefore, in terms of the interpretation, the disclosure requirements of IAS 16: Property, plant and equipment or IAS 38: Intangible Assets should apply.*

EFRAG believes that the disclosure requirements of IAS 16 should apply and that the need for an interpretation relating to the treatment of stripping cost is an indication that such assets are material enough to warrant separate presentation in the notes to the financial statements.

- 25 In order to reduce diversity in practice, we believe that the DI should require the application of the disclosure requirements of IAS 16.
- 26 Furthermore, EFRAG believes that this interpretation should require entities to present separately the aggregate of capitalised stripping cost as a sub-component of the mining asset to which it relates.

Question 4 – Transition

- (a) Do you agree that this requirement is appropriate? If not, what do you propose and why?
- (b) Do you agree with the proposed treatment of existing stripping costs balances? If not, what do you propose and why?

Notes to EFRAG's constituents

- 27 *The DI should be applied to production stripping costs incurred on or after the beginning of the earliest period presented.*
- 28 *Those existing stripping cost asset balances should be reclassified as a component of the already existing asset to which the stripping cost relates, if and only if, those stripping costs can be specifically attached to the section of the ore body. Those reclassified balances should be depreciated or amortised over the expected useful life of the specific section of the ore body to which the stripping campaign component relates.*
- 29 *If those existing stripping costs assets cannot be specifically attached to a specific section of the ore body, the entity should recognise the stripping costs previously capitalised in the profit and loss of the earliest period presented. The balances that exist can either be an asset or liability, hence, any allocations to the profit and loss could either be recorded as a day one type loss or a gain in the comparative period income statement.*
- 30 *An Amendment to IFRS 1: First-time Adoption of International Financial Reporting Standards is proposed. A first-time adopter of IFRS will be exempt from full retrospective application of production stripping costs if they elect to apply the exemption. However, the proposed exemption can only be used where the effective date is earlier than the date of transition to IFRS or where the entity early adopts the DI.*

EFRAG thinks the requirements of IAS 8 should apply.

EFRAG does not agree with the treatment of already existing production stripping assets and liabilities.

- 31 EFRAG thinks the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should apply rather than the transition provisions contained within the DI. EFRAG supports retrospective application where possible as it provides the basis for comparative information. If, however, it is impracticable to apply full retrospective application then prospective application would, under IAS 8, apply from the earliest date practicable. This would be consistent with the transition provisions of IAS 16, which also requires full retrospective application.
- 32 If the proposals in the DI were to be taken further, we disagree with the treatment of existing production stripping assets and liabilities that cannot be specifically attached to a specific section of the ore body. The proposals to adjust the comparative profit and loss account significantly reduce the comparability of financial statements. In addition, the basis for conclusions does not provide any arguments for this treatment of day-one adoption type gains and losses or what they represent.