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HK(IFRIC) INTERPRETATION 20 STRIPPING COSTS IN THE PRODUCTION PHASE OF A SURFACE MINE

In November 2011, the Hong Kong Institute of Certified Public Accountants issued HK(IFRIC) Interpretation 20 (HK(IFRIC)-Int 20) *Stripping Costs in the Production Phase of a Surface Mine*. The Interpretation is a textual copy of IFRIC Interpretation 20 (IFRIC 20) developed by the IFRS Interpretations Committee (IFRIC), the interpretative body of the International Accounting Standards Board.

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 typically known as 'stripping'. 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 on a systematic basis, usually by using the units of production method, once production begins.

Although there is consistency of accounting for stripping costs in the development phase, this is not the case once the production phase has commenced. 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 improvements. Consequently, the IFRIC was asked to issue guidance on the accounting for stripping costs in the production phase of a mine.

The requirements of this Interpretation are based on the concept that material that is removed when stripping activities are carried out in the production phase will not necessarily be 100% waste; often it will be a combination of ore and waste. Removal of material with a low ratio of ore to waste may produce some usable material, which can be used to produce inventory. This removal might also provide access to deeper levels of material that have a higher ratio of ore to waste. There can therefore be two benefits accruing to the entity from the stripping activity: usable ore that can be used to produce inventory and improved access to further quantities of material that will be mined in future periods.

The guidance set out in this Interpretation considers when and how to account separately for these two benefits arising from the stripping activity, as well as how to measure these benefits both initially and subsequently.

STATUS
Final

EFFECTIVE DATE
Annual periods beginning on or after 1 January 2013

ACCOUNTING IMPACT
Clarification of when and how to account for stripping costs

Recognition of production stripping costs as an asset

HK(IFRIC)-Int 20 clarifies that removed material that can be used to build up inventory is accounted for in accordance with the principles of HKAS 2 *Inventories*. The other removed material, that provides access to deeper levels of material that will be mined in future periods, is recognised as a non-current asset (referred to as a 'stripping activity asset') if, and only if, all of the following criteria are met.

- It is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity 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 not recognised separately because the IFRIC took the view that the stripping activity asset was more akin to being a part of an existing asset. Accordingly, the stripping activity asset is added to an existing asset and accounted for as part of that asset. The IFRIC considered that the stripping activity asset might add to or improve a variety of existing assets, for example the mine property, the mineral deposit itself, an intangible right to extract the ore or an asset that originated in the mine development phase. The nature of the existing asset determines whether the stripping activity asset is classified as tangible or intangible.

Initial measurement of the stripping activity asset

At initial recognition the Interpretation requires stripping activity assets to be measured at cost. Only costs that are directly incurred to perform the stripping, plus an allocation of directly attributable overhead costs, including items such as an allocation of salary costs of the mine supervisor overseeing that component of the mine, are capitalised. Incidental operations, that may take place at the same time but are not necessary for the production stripping activity, do not qualify for capitalisation.

Because stripped material often contains ore as well as waste, it is necessary to allocate costs incurred between the stripping activity asset and inventory. However, because the stripping activity may give rise to both of these assets at the same time, it may not be possible identify the costs that relate specifically to each of them. In these cases, costs are allocated on the basis of a relevant production measure. The approach is to allocate the 'normal' production costs to inventory with the excess being considered for capitalisation. This requires identification of when a level of activity has taken place which is in excess of that which would be expected to be required only for the production of inventory. The additional activity (and associated costs) may have resulted in access to additional ore deposits and hence a future benefit. HK(IFRIC)–Int 20 includes the following examples of relevant production measures:

- cost 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 the stripping activity asset

Stripping activity assets are subsequently measured in the same way as the asset to which they have been added. Consequently, they are carried either at cost or revalued amount less depreciation or amortisation and any impairment losses.

Depreciation or amortisation is calculated on a systematic basis (the unit of production method is required to be used unless another method is more appropriate), 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 principles of HKAS 36 *Impairment of Assets* would be applied to the existing asset of which the stripping activity asset is a part, and not at the level of the stripping activity asset itself.

Effective date and transition

The Interpretation is effective for annual periods beginning on or after 1 January 2013. Production stripping costs incurred on or after the beginning of the earliest period presented should follow the accounting requirements in this Interpretation. Earlier application is permitted. If an entity applies HK(IFRIC)-Int 20 for an earlier period, it is required to disclose that fact.

Where the entity's existing accounting policy is to capitalise production stripping costs, the accounting for predecessor stripping asset balance on transition to HK(IFRIC)-Int 20 is determined by whether there remains an identifiable component of the ore body with which the predecessor stripping asset can be associated.

The predecessor stripping asset balance is reclassified as a part of an existing asset to which the stripping activity related to the extent that there remains the identifiable component of the ore body. The subsequent depreciation or amortisation of the reclassified balance follows the requirements in the Interpretation.

Where there is no identifiable component of the ore body to which a predecessor stripping asset relates, the asset balance is derecognised with the amount debited to retained earnings at the beginning of the earliest period presented.

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