30 November 2010

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON DRAFT INTERPRETATION ON *STRIPPING COSTS IN THE PRODUCTION PHASE OF A SURFACE MINE*

In response to your request for comments on the IFRS Interpretations Committee's Draft Interpretation on *Stripping costs in the Production Phase of a Surface Mine* attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

Integritas, 7 Zulberg Close, Bruma Lake, 2198 POSTAL ADDRESS PO Box 59875, Kengray, 2100, Johannesburg
TEL +27 11 621 6600 FAX +27 11 621 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za

SAICA SUBMISSION ON DRAFT INTERPRETATION ON *STRIPPING COSTS IN THE PRODUCTION PHASE OF A SURFACE MINE*

GENERAL COMMENTS

We support the IFRS Interpretations Committee in addressing the accounting treatment of stripping costs to improve consistency. While we are in agreement with the intention of the draft Interpretation, we believe that the drafting could be improved to focus more on the accounting principles which distinguish the different types of stripping activities.

SPECIFIC COMMENTS

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?

No, we do not believe that the proposed definition satisfactorily distinguishes between a stripping campaign and routine waste clearing activities for the following reasons:

- It relies on the concept of a stripping campaign being "a more aggressive process than routine waste clearing activities". It is not clear what is meant by "more aggressive" and "routine waste clearing activities" are not defined. Our concern is that such a distinction is vague and too subjective and would probably result in diversity in practice. In addition, many of the current practices have as their objective, the normalisation or averaging of waste clearing costs over the life of the mine. Based on discussions with industry representatives, some entities have indicated that they would interpret "a more aggressive process" as being one in which the waste to ore stripping ratio is higher than the average expected stripping ratio for the life of the mine in order to achieve some sort of smoothing of waste costs. Therefore, we believe that the final Interpretation should clarify whether such an approach would be acceptable. Some of our constituents do not believe that such an approach is acceptable because this results in capitalisation of costs simply where the current strip ratio is higher than the average or long-term strip ratio, rather than based on whether the stripping activity gives rise to an enduring benefit (i.e. access to an ore body that will be mined in future periods – see below).

- The definition is not based on an accounting principle. We believe that the final Interpretation should focus on whether the stripping activity provides an enduring benefit, being one that will provide economic benefits in one or more future periods. This ties in with the definitions of property, plant and equipment and intangible assets, which the draft Interpretation proposes to interpret. If the activity relates to the extraction of ore in the current period, the related costs are production costs and should be treated in accordance with IAS 2 – *Inventories*. This is because the benefits of the stripping activity are realised in the current period. As with stripping costs incurred in the development phase (which the draft Interpretation acknowledges are capitalised as part of the "… cost of building, developing and constructing the mine"); a stripping activity that is undertaken to access part of the ore body that will only be extracted in one or more future periods (i.e. beyond the current annual reporting period) provides a future economic benefit. Accordingly, the costs of such a stripping activity should be capitalised as part of the cost of the related asset.

- We also believe that the recognition criterion in the Framework that an asset needs to have a cost or value that can be measured reliably, should also be addressed in the final Interpretation. We believe that this is important because the cost of the stripping campaign needs to be able to be measured reliably to qualify for capitalisation. If this is not the case, the costs should be expensed. Therefore, where entities are not able to distinguish operationally between routine stripping and a stripping campaign, the costs of the stripping campaign would not be able to be measured reliably and hence all waste clearing costs would be expensed.

Although we believe that the definition should be based on an accounting principle, we do believe that the definition should include additional guidance to assist in the application of the principle. Therefore, once the principle is established, stripping costs which relate to production could be referred to as 'routine stripping costs' and the other stripping costs could be referred to as a 'stripping campaign'. Additional guidance in the definition would be useful since we do acknowledge that in some circumstances it may be difficult to measure reliably the stripping costs related to a stripping campaign as compared to routine stripping.

Further guidance of what constitutes a stripping campaign could incorporate the features proposed in the draft interpretation (i.e. "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."). In addition we believe the following features should be included:

- As noted in BC14 it would be a significant 'push-back', which in terms of the mine plan is aimed at accessing part of the ore body that will only be extracted in one or more future periods beyond the current financial year. Therefore, operationally, it would not relate to ore extracted in the current period.

- It would generally require board approval because it is a significant activity aimed at accessing the ore body for future extraction rather than being a current period production activity.

In this regard, some of our commentators believe that the illustrative examples (although quite simplistic) are useful in highlighting the distinction between the two types of stripping activities.

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?

Many of our constituents do not agree that the stripping campaign component should be depreciated or amortised over the specific section of the ore body that becomes accessible as a result of the stripping campaign. They believe that it should be amortised over the life of the mine. Stripping campaigns are designed not only to access the ore body for current processing but also to provide the platform for access to known and identified sections of the ore body for future processing. Removal of one area of overburden generally gives access to a wider ore body than the entity previously had access to and therefore gives rise to probable future economic benefits. The enduring benefit derived from the stripping campaign is therefore not limited to the ore body accessed directly. The mine plans of companies (although dynamic) generally provide a good indication of the level of ore body that is expected to be accessed over the life of mine and over what period. Therefore by removing waste to access sections of the ore body access is gained to other parts of the ore body and the cost incurred in the stripping campaign should be depreciated/amortised over the life of mine. Those not in favour of the proposal believe that the allocation of stripping costs only to the directly accessible reserves would not reflect the economic benefits expected to be derived from the overall stripping campaign.

Notwithstanding the aforementioned argument, some of our constituents are supportive of 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. Although not stated in the draft Interpretation, those supportive of the proposal understand that the reason for requiring depreciation over the specific section of the ore body that becomes accessible rather than over the remaining life of mine, is that the entity is not yet committed to access more of the ore body beyond the current stripping campaign. Hence, it would be inappropriate to anticipate the future economic benefits that may be derived from future (yet uncommitted) stripping campaigns to access those sections in the future. The final Interpretation should expand on the reason for the proposed depreciation approach

Although paragraph 9 proposes that the cost of the stripping campaign would be accounted for as an addition to, or an enhancement of, an existing asset (with which we agree), the proposals regarding subsequent measurement (paragraphs 16-19) appear to treat the stripping campaign component as if it were a separate asset. In particular, paragraph 16 requires the subsequent measurement to be cost less depreciation/amortisation and impairment losses. Although we are not aware of any mining company that has adopted a revaluation model for their mining assets, if the stripping campaign is a component of an existing asset, we believe that the measurement model being applied to that asset should be applied to the entire asset, including the stripping component. Under IAS 16 – *Property, Plant and Equipment* or IAS 38 – *Intangible Assets,* different measurement models cannot be applied to different components of an asset. In addition, paragraph 19 requires consideration of the stripping campaign component for impairment in accordance with IAS 36 – *Impairment of Assets*. This would also appear to conflict with the unit of account for impairment under IAS 36 being an individual asset (if it is possible to determine its recoverable amount) or a cash-generating-unit. We do however believe that if the extraction of the ore that is specifically associated with the stripping campaign component is no longer going to take place that such a component should be derecognised.

(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?*

Yes, we agree with the Board's proposal.

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?

Yes, we believe the requirement to provide disclosures required for the existing asset is sufficient because the stripping campaign component is part of the existing asset – it is not a separate asset.

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.

Yes, from a practical perspective we agree with the proposal relating to stripping costs incurred on or after the beginning of the earliest comparative period.

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

Paragraph 22 of the draft Interpretation requires that "*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****."* (emphasis added).

We recommend that where existing stripping cost asset balances can be related to a specific section of the ore body, they should be depreciated or amortised over the *remaining* expected useful life of that specific section of the ore body. We also believe that the effects of derecognising existing stripping cost assets that do not meet the asset recognition criteria and derecognising stripping liabilities should be accounted for as adjustments to retained earnings at the beginning of the earliest period presented as opposed to profit or loss. This would be consistent with the accounting for the effects of initially applying other Interpretations of Standards. The words "at the *beginning* of the earliest period" appear to imply that it is not intended that the effects are recognised in the comparative period's profit or loss. However, to ensure there is no doubt, we suggest that reference is made to 'retained earnings' rather than 'profit or loss'.

OTHER COMMENTS

Illustrative examples

Our constituents were split regarding whether the illustrative examples should be retained in the final Interpretation. Those not in favour are of the view that the examples are too simplistic and do not necessarily reflect most ore bodies in real life. Those in favour believe that, even though the examples may be simplistic, they are a powerful illustration of the intended application of the draft Interpretation. Most people use pictures to understand complex concepts.

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