

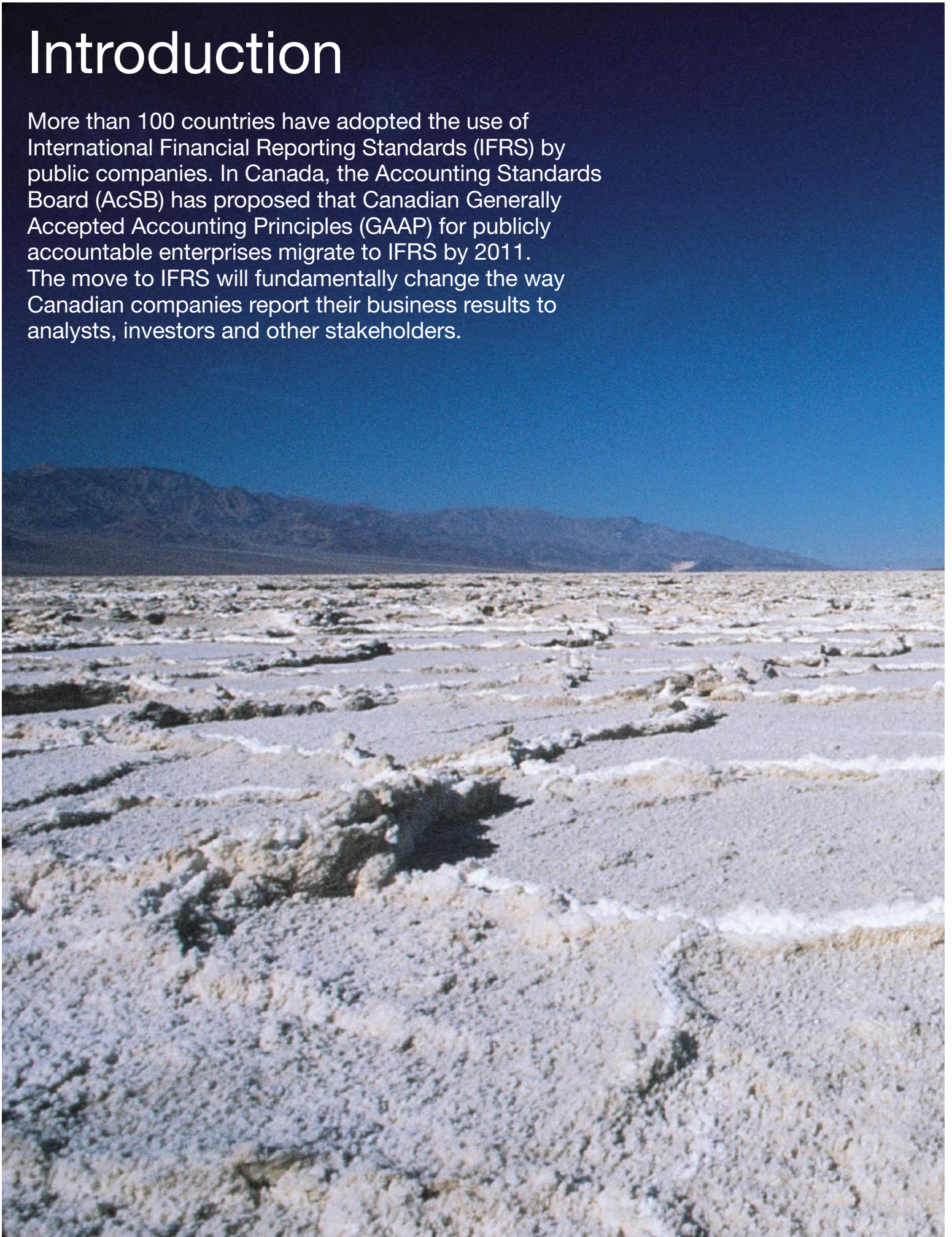
Putting IFRS in motion*

The impact of International Financial Reporting Standards (IFRS) on the Canadian mining sector



Introduction

More than 100 countries have adopted the use of International Financial Reporting Standards (IFRS) by public companies. In Canada, the Accounting Standards Board (AcSB) has proposed that Canadian Generally Accepted Accounting Principles (GAAP) for publicly accountable enterprises migrate to IFRS by 2011. The move to IFRS will fundamentally change the way Canadian companies report their business results to analysts, investors and other stakeholders.



For many organizations, implementing IFRS may be quite a simple exercise, but for others it may be a highly complex process that goes well beyond the finance and accounting functions. Other business operations such as human resources, investor relations, business development and Information Technology (IT) departments will likely be involved in the IFRS conversion plan.

Our experience in assisting numerous global companies that have already adopted IFRS shows that for some, full conversion and adoption can take anywhere from two to five years, depending on the complexity of the organization.

Certain industries have a long and complex conversion process because significant accounting policy changes are required. It is often extremely difficult to extract the historical information necessary to make these changes and the accounting processes and systems have to be modified on a go forward basis.

One of the most significant challenges in converting from Canadian GAAP to IFRS is determining which GAAP differences will impact the organization. The AcSB intends to work towards eliminating existing differences between Canadian GAAP and IFRS over the transition period by adopting new standards that will continue to emerge as a result of global accounting standard setters' desire to harmonize frameworks. Organizations will need to be responsive to take these changes into account in their project plans.

This publication outlines some of the significant accounting differences that arise between Canadian GAAP and IFRS in the mining sector.

Companies that have already implemented IFRS understand that the new standards may place a sizeable responsibility on management to be able to communicate effectively to the market in the new IFRS language.

Accounting under IFRS



In Canada, Canadian GAAP will migrate to IFRS over a transition period ending in 2011. The move to IFRS will change the way Canadian companies present their business results to analysts, investors and other stakeholders. The implementation of IFRS for Canadian mining companies may at first look like a complicated, expensive and difficult process. However, the size and complexity can be managed if companies plan ahead before the new accounting and reporting standards become effective.

Many mining companies throughout Europe, Africa and Australia have completed their transition and have been applying IFRS since January 1, 2005. The transition to IFRS for mining companies in these countries has shown there are some interpretation and application problems unique to the mining industry.

An Extractive Activities working group has been formed by the International Accounting Standards Board (IASB) to develop formal guidance for mining activities but decisions are not expected before 2009. Some of the key areas of focus of this working group include:

- Consideration of whether to continue using existing definitions or to develop an overarching definition(s) of reserves and resources that identifies the principal features of reserves and resources for use in either or both of the recognition and disclosure of reserves and resources.
- Consideration of a model which records the reserves and resources at fair value with movements in such value being recorded as “profit” for the period. The challenge with such a model is that companies need to be able to provide reliable and consistent measures of reserves and resources across the industry and there are significant issues related to the measurement criteria which would need to be addressed before such concepts could be introduced.
- Consideration of whether costs incurred prior to the recognition of a reserve and resource in the financial statements should all be expensed or if some should be capitalized.
- Consideration of the information on reserves and resources that should be disclosed in financial statements.

Such guidance may or may not be available by the time Canadian mining entities are required to adopt the new standards. In the meantime, mining company executives will need to make decisions with respect to accounting policies expected to be adopted on transition.

The PwC publication *Financial reporting in the mining industry* outlines the mining-specific accounting issues in detail. This publication is available at www.pwc.com/mining

The following sections of this publication highlight the significant differences between Canadian GAAP and IFRS which will specifically impact mining companies.



Exploration and evaluation

A variety of accounting practices are currently followed in Canada for exploration and evaluation expenditure. Some mining entities capitalize all such expenditure as a matter of policy, while others write off exploration costs as incurred until such time as it is considered probable that a mine will be developed based on a feasibility study showing that the reserves can be economically exploited.

IFRS 6, which specifically deals with such expenditure, allows mining entities to retain their existing policies for the capitalization of exploration and evaluation costs until more definitive guidance is developed in this area.

IFRS 6 also provides specific guidance on:

- Facts and circumstances which indicate that an entity should test exploration and evaluation assets for impairment. Should such facts and circumstances indicate potential impairment, IAS 36 is followed in determining whether an impairment charge is required, and if so, the amount.
- The level at which exploration and evaluation assets are assessed for impairment. An accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment is required. Each cash-generating unit, or group of units to which an exploration and evaluation asset is allocated, should not be larger than an operating segment determined in accordance with the international accounting standard on segment disclosures.

Development

The mining industry is characterized by projects that often have long commissioning periods, during which production is ramped up towards the design capacity. The treatment of revenues and costs incurred during these periods is subject to a degree of judgment because IAS 16, the international standard for property, plant and equipment, does not specifically consider the complexities of the mining industry where, in the start-up phase, significant revenue may be generated and the costs incurred may be both development and operating in nature. IAS 16 only allows capitalization of start-up and similar pre-production costs which are directly attributable to bringing the asset to the location and condition necessary for it to be operating in the manner intended by management. Canadian GAAP currently allows deferral of start-up costs under certain conditions but GAAP is evolving in this area. Mining company executives will need to revisit their existing policies under Canadian GAAP and consider aligning them with accepted practice under IFRS on transition.

The treatment of borrowing costs also arises as an accounting issue during the development stage. Currently, Canadian GAAP provides little guidance on the capitalization of borrowing costs whereas IFRS requires all borrowing costs incurred which are directly attributable to the development of an asset to be capitalized.

Another key area of consideration during the development phase of a mining operation is the recognition of decommissioning and restoration liabilities at each period end reflecting the disturbance caused to the site at that date. The inherent difficulties in initial and subsequent measurement of such liabilities will remain under IFRS because the guidance in this area is currently less comprehensive than the guidance currently available under Canadian GAAP. There are also certain differences in the methodology used for the measurement of such liabilities. For example, IFRS requires the use of current interest rates in subsequent measurement of liabilities. As a result, there may be differences in the way in which such liabilities will be measured under IFRS.

Production

There are a number of unique areas of accounting in the production phase of a mining entity which will require careful consideration on adoption of IFRS. Some of these areas include:

Depreciation – the methodologies available under IFRS for depreciation of property, plant and equipment are similar to those currently employed under Canadian GAAP. There is currently no specific guidance under IFRS on whether value beyond proven and probable reserves or whether future capital expenditure should be taken into account in determining the depreciation base of assets. These areas will need to be monitored for future developments or convergence with US GAAP.

Deferred stripping – recent guidance issued in Canada prohibits the deferral of production-stage stripping costs (unless they result in the betterment of the asset) and requires that they are treated as a variable production costs from 2007. Currently IFRS does not provide guidance as to how production-stage stripping costs should be treated. As such, there is varying practice in the accounting for deferred stripping, with many companies deferring such costs and amortizing them over the life of mine stripping ratio. IFRS may converge with the US and Canadian standards in this area in the near future.

Impairment – IAS 36, the international standard on impairment, differs significantly from the current Canadian GAAP standards. At each reporting date under IFRS, companies are required to assess whether there are any indications of impairment. This periodic assessment is not currently required under Canadian GAAP. Both GAAPs require assets to be tested for recoverability whenever events or circumstances that indicate

that the carrying amount may not be recoverable. However, under IFRS, there is no separate step for assessment of recoverability based on undiscounted cash flows as there is under Canadian GAAP. Rather, the carrying value is compared to the higher of 'value in use' and 'fair value less costs to sell' in determining whether an impairment charge is required and if so, the amount. This difference may result in companies requiring write-downs of assets under IFRS which were previously considered recoverable using the undiscounted cash flow test under Canadian GAAP.

There are also a number of complications in the application of IFRS in calculating 'value in use' for impairment purposes for mining companies. These include the determination of appropriate long-term price assumptions, the requirement to use spot exchange rates at the date of the calculation (which may be inconsistent with the exchange assumptions embedded with the price assumptions) and the restriction on inclusion of future capital improvements or cost savings. There is no similar specific requirement to use spot exchange rates to translate foreign currency cash flows in 'Value in Use' models under Canadian GAAP (although the use of future exchange rates discounted back to spot values may not produce significantly different outcomes).

Another significant difference to the current Canadian standards is that IFRS requires the reversal of previous impairment losses where there is an indication that the loss may no longer exist or may have decreased. This requirement may lead to volatility in the income statements of mining companies with impairments recorded and reversed in relatively quick succession in response to changes in the commodity cycles.

Joint ventures – joint ventures to develop ore bodies are common in the mining industry as they allow entities to share the risks and significant capital costs of mineral exploration and development with other entities. IFRS defines three types of joint ventures: jointly controlled assets (JCAs), jointly controlled operations (JCOs) and jointly controlled entities (JCEs). JCAs and JCOs (being joint ventures which are not constituted in an entity) are currently required to be proportionately consolidated under IFRS providing a similar treatment to that currently employed under Canadian GAAP. JCEs may also currently apply proportionate consolidation under IFRS although the standard allows an alternative to equity account for such joint ventures which are set up as an entity. This allows an entity to adopt a different accounting treatment simply because of the legal form the joint venture takes—even though, in substance, the JCE may operate on an almost identical basis to an unincorporated JCA. It should be noted, however, that this treatment is currently under review as the IASB has a project in progress which aims to align IFRS with existing US GAAP requirements for joint ventures which prohibit the use of proportionate consolidation except where there is undivided interest.

Functional currency – IFRS provides more definitive guidance relating to functional currency and how it is determined than the current Canadian standards. IAS 21 requires the functional currency of each component within a Group structure to be determined and all transactions measured with reference to this currency. The determination of this currency can prove difficult in mining companies as many commodities are sold in US dollars which may differ from the currency influencing the costs of producing the commodity. As such, judgment is required to determine the functional currency of each entity within a Group and different conclusions may be reached by different companies. The change to IFRS may or may not change the accounting for foreign currency translation from the existing

treatment under Canadian GAAP (which assesses whether subsidiaries within a Group are self-sustaining or integrated with the parent). However, companies will need to conduct an analysis of the functional currencies of each entity within a Group, to ensure the provisions of IAS 21 are addressed.

Business combinations – IFRS has different requirements than Canadian GAAP for the determination of the consideration paid and fair value of assets acquired which will need to be considered for all business combinations. In addition, the distinction between an asset purchase and a business combination is particularly important under IFRS as deferred tax is generally not recognized on an asset acquisition (due to the “initial recognition” exemption) but is for a business combination. In contrast, under Canadian GAAP, when an asset is acquired, in a means other than in a business combination, and the tax basis of that asset is greater than its cost, the benefit related to future income taxes recognized at the time of acquisition should be deducted from the cost of the asset.

It should be noted that the IASB and FASB have commenced a project on business combinations to develop new requirements for purchase method procedures. The Accounting Standards Board in Canada has indicated that they intend to issue converged standards at the same time. This will eliminate any Canadian GAAP to IFRS differences if completed prior to the transition date.

Derivatives and hedging – the recent adoption of the new financial instruments standards in Canada has closely aligned Canadian GAAP with IFRS. There are, however, certain subtle differences in the standards applicable to derivatives and hedging which will require consideration on transition. This is a complex area which affects many mining companies who use financial and non-financial derivatives to hedge cash flows and the value of asset and liabilities.

Conversion is not just a technical accounting exercise

IFRS will present unique challenges for senior management, the financial reporting function, the treasury function and many other areas across the organization. IFRS may impact existing management reporting including budgets, forecasts, performance measures, reward schemes and bonus structures, key performance indicators and covenants. Furthermore, new procedures should be considered to ensure IFRS implications are considered as part of the approval process for all new strategic investments. Depending on the size and complexity of the organization, most mining companies will likely find that their human resources, IT, investor relations and business development departments will need to be involved in planning this transition.

IFRS across the organization		
<p>Implementation Resources</p> <ul style="list-style-type: none"> • Need for resource over 12-18 months • Competing projects • Not just a finance issue <p>Training and Education</p> <ul style="list-style-type: none"> • All finance staff will need some training • Broader awareness of the issues • Other business professionals within organization • Executives need to be able to understand and explain the “new” numbers 	<p>Acquisitions</p> <ul style="list-style-type: none"> • Need for IFRS figures for due diligence • Models required for annual goodwill impairment tests <p>Financing/Refinancing</p> <ul style="list-style-type: none"> • Impact of IFRS on earnings or asset-based debt covenants <p>Remuneration</p> <ul style="list-style-type: none"> • Impact of earnings volatility on profit-based bonus plans 	<p>Systems and Processes</p> <ul style="list-style-type: none"> • Need for different/new data • New systems <p>SOX/ICOFR Certification</p> <ul style="list-style-type: none"> • Process/control documentation updates <p>Investor Relations</p> <ul style="list-style-type: none"> • Preparing analysis for the impact of IFRS <p>Management Reporting</p> <ul style="list-style-type: none"> • Budgets, forecasts, management accounts and KPIs (Key Performance Indicators) need to be on an IFRS basis

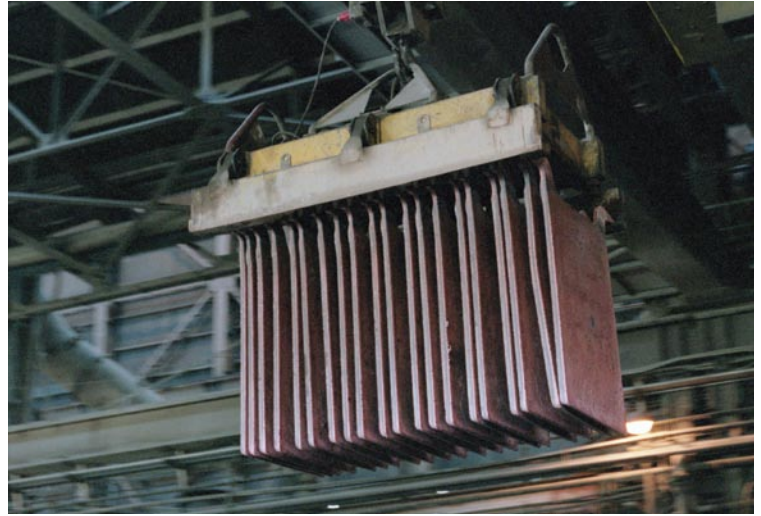
Communication

The financial statements of a Canadian mining company will look different under IFRS than they currently do under Canadian GAAP. Senior executives need to be prepared to discuss the reasons for, and nature of, the differences to board members, shareholders, the investment community and financial analysts. A detailed communication plan is necessary to educate stakeholders and actively manage perceptions.

There are a number of areas within IFRS which are subject to interpretation. While a primary aim of the IASB is to have a global set of standards applied consistently, the reality is that there are differences in the specific application of a particular accounting rule from one company to another.

Communication of key policy choices, interpretations and accounting decisions in some detail may also be necessary to differentiate and explain a mining company's financial results under IFRS as compared to its peers.

Our experience with companies in Europe has shown that early communication, including the sharing of pro forma financial statements with preliminary figures and/or opening balance sheets under IFRS—in advance of transition date—has allowed investors and analysts to understand and get comfortable with financial results and their presentation. In contrast, late or absent dialogue with key stakeholders concerning the financial implications of the adoption of IFRS could result in a direct impact on share price.



Impact on systems and processes

IFRS compliance may require the realignment of reporting systems for new and additional data.

Our experience has shown that many companies implementing IFRS underestimate the time and resources needed to meet this challenge. This is especially true with existing management systems or legacy systems from past acquisitions that have never been updated and are not geared to provide sufficient or appropriate data for preparing new and increased disclosures. To make the best decisions on IT investment and achieve user engagement, it's important that company IT executives have sufficient time to perform systems realignment and are not forced to complete this work in a "fire-drill" environment.

Other process changes under the move to IFRS can be equally as important and may include the following:

- Revising existing reporting templates and other checklists to incorporate data required for disclosures under IFRS;
- Rationalizing or expanding the chart of accounts to post additional measurement changes and/or collect additional disclosures under IFRS;
- Reviewing period-end close procedures to achieve efficient close times;
- Reviewing outsourced operations' controls and capability in producing IFRS compliant information; and
- Obtaining IFRS information from significantly influenced investees and/or variable interest entities.

Education, awareness and culture

The migration to IFRS may also require a training program that combines knowledge transfer with the ability to address skills, attitudes and motivation. The entire organization, not just finance and accounting, will need to be trained in this area (e.g. functions such as internal audit and investor relations). Training should focus on what information individual business units will need to provide in order to comply with IFRS and how IFRS will affect their decision-making and value creation strategies.

Early awareness training on the important impact areas and changes under IFRS will enable key stakeholders, such as key executives and board members, to be fully briefed on the new requirements and help drive a positive spirit of change management throughout the organization.

Regulatory requirements

The adoption of IFRS will require Canadian entities to consider various regulatory requirements.

US considerations

The SEC recently approved the issuance of a Concept Release eliminating the requirement that foreign private issuers using IFRS must reconcile their filings with the SEC to US GAAP. Therefore, entities that prepare US GAAP reconciliations for their US filings may see the elimination of these requirements with the move to IFRS. The SEC is working towards eliminating the need for companies reporting under IFRS to reconcile to US GAAP by 2009 at the latest.

However, companies must not forget certain current legal requirements to have Canadian GAAP financial statements right up to the IFRS transition date.

Internal controls over financial reporting

Public companies will also need to consider Multilateral Instrument 52-109 (certification of disclosure in issuers' annual and interim filings) and Sarbanes-Oxley requirements (management assessment of internal controls) as they transition to IFRS. Specifically, entities will need to update their documentation on the internal controls over financial reporting and related evaluation procedures for processes and changes impacted by the IFRS migration.

Mergers and acquisitions implications

The move to IFRS may add increased complexity to M&A transactions in countries which have not yet adopted IFRS.

The main challenges will be the need to translate the target's historical and projected performance into IFRS to assess the accounting implications of the transaction and to understand the impact on the acquirer's earnings per share.

Complexities in IFRS accounting will lead to tougher due diligence requirements when evaluating targets in the mining sector, even if the target is already reporting under IFRS.

Given that a number of areas of IFRS specifically affecting mining companies require judgment and interpretation, comparability and consistency in the application of IFRS across countries and companies could vary markedly. Acquirers may need to devote more time and resources to scrutinizing how target's numbers have been produced.

The potential cost of bringing the target's reporting systems up to the acquirer's standards, and the time required to do this, could significantly affect a company's ability to realize integration synergies especially as we get closer to the transition date.

To the extent that a Canadian entity completes any acquisition of a target company not currently reporting under IFRS before 2011, they will need to include the target companies in their IFRS conversion and readiness plan.

Our experience assisting companies on M&A transactions has shown that they have struggled to obtain the additional data and disclosure requirements of target companies under IFRS.

Planning an effective conversion

It is easy to underestimate the volume and complexity of the work involved with the implementation of IFRS.

Our experience in Europe and Australia has shown that some companies transitioning to, or applying, IFRS for the first time will try to make manual adjustments from local GAAP to IFRS using spreadsheets or similar tools. These quick fix conversions are often not the most cost-effective choice in the long run—especially as these fixes can be prone to error, confusion and typically lack the appropriate internal controls surrounding its preparation.

To ensure sustainable and uniform application of IFRS throughout your organization, you will need to document your accounting policy selections and make sure they are consistently followed.

This publication does not provide a complete list of GAAP differences that Canadian mining companies need to consider upon transition to IFRS.

Each individual company will have unique circumstances that require sound judgment and expert advice. Advanced planning and an in-depth diagnostic of how IFRS will effect your company's financial reporting will reduce the risk associated with compliance and lower the overall cost of transition.



How we can help

The most viable approach to IFRS conversion will vary from one organization to another.

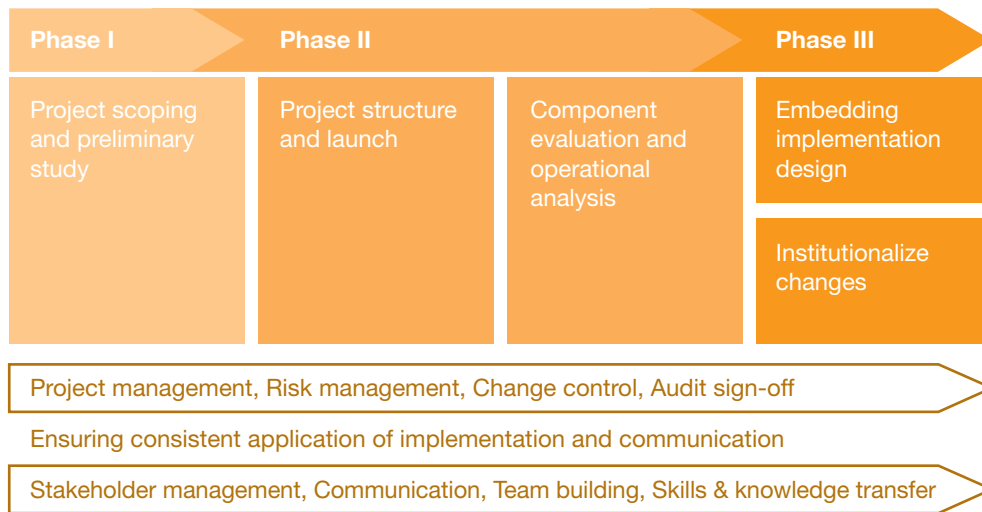
Our experience has shown that a critical success factor for IFRS conversion is a well-planned implementation, which is started several years in advance of the required convergence date.

PricewaterhouseCoopers teams around the world have worked with an impressive list of mining clients in implementing IFRS and have considerable experience helping mining companies deal with these challenges.

We've recently completed IFRS conversions for Canadian clients in the resources sector and have completed conversions for a number of global mining companies.



Phases of IFRS Implementation



We can help you plan and complete your transition to IFRS by providing:

- An initial diagnostic of Canadian/IFRS accounting differences;
- Advice on the selection of appropriate accounting policies;
- Advice on the development of IFRS implementation plans;
- Communication strategies and change management support;
- IT and process improvements;
- Competitor benchmarking;
- M&A target accounting conversion assistance;
- Valuation advice under IFRS fair value and impairment models; and
- Tax planning considerations on conversion to IFRS.

Our multi-disciplinary approach and diversified experience can help you plan ahead and manage the size and complexity of your conversion.

Our Mining IFRS Group

To combine our collective experiences and promote consistency across our clients, we have established a mining IFRS group comprising mining specialists from some of the key territories in which IFRS is currently being adopted or already applies, including the UK, Australia, South Africa and Indonesia. The group has developed mining-specific solutions for a wide range of accounting issues and plays a key role in resolving new issues that emerge.

The IASB has asked a group of national standard setters to undertake a research project that will form the first step towards the development of an acceptable approach to resolving accounting issues that are unique to upstream extractive activities. The primary focus of the research project is on the financial reporting issues associated with reserves and resources. PwC participates in the advisory panel which has been established to provide advice throughout the research project.

We support the IASB's project to consider the promulgation of an accounting standard for the extractive industries; we hope this will bring consistency to all areas of financial reporting in the extractive industries. The mining industry is arguably one of the most global industries and international comparability would be welcomed.

If you would like to discuss any of the issues raised in this paper, please speak to your usual contact at PricewaterhouseCoopers, or any of the contacts listed on the opposite page.

Global Capital Markets Group

Our Global Capital Markets Group (GCMG) leads GAAP conversions for a wide range of organizations—from large complex companies requiring detailed analysis to desktop reviews for local reporting requirements.

Our GCMG in Canada, led by Geoff Leverton, is part of a Global team of IFRS conversion specialists comprising over 80 partners and staff specializing in multi-GAAP environments and the related conversion implications. This team has worked almost exclusively on IFRS conversions over the last three years and has played a leading role in developing the firm's conversion methodology. The team is also able to draw on the firm's wider technical and industry resources.

Contacts

Toronto

Paul Murphy
paul.j.murphy@ca.pwc.com
416 941 8242

Vancouver

Lenard Boggio
lenard.f.boggio@ca.pwc.com
604 806 7016

Craig McMillan
craig.mcmillan@ca.pwc.com
604 806 7724

Other Specialized Experts

Geoff Leverton,
Global Capital Markets Group
geoff.m.leverton@ca.pwc.com
416 815 5053

James Saloman,
Professional, Technical, Risk & Quality
james.s.saloman@ca.pwc.com
416 941 8249

Kevin Hinz, Tax
kevin.a.hinz@ca.pwc.com
403 509 7567

Spence McDonnell, Tax
spence.n.mcdonnell@ca.pwc.com
416 869 2328

Kristian Knibutat, Valuations
kristian.knibutat@ca.pwc.com
416 815 5083

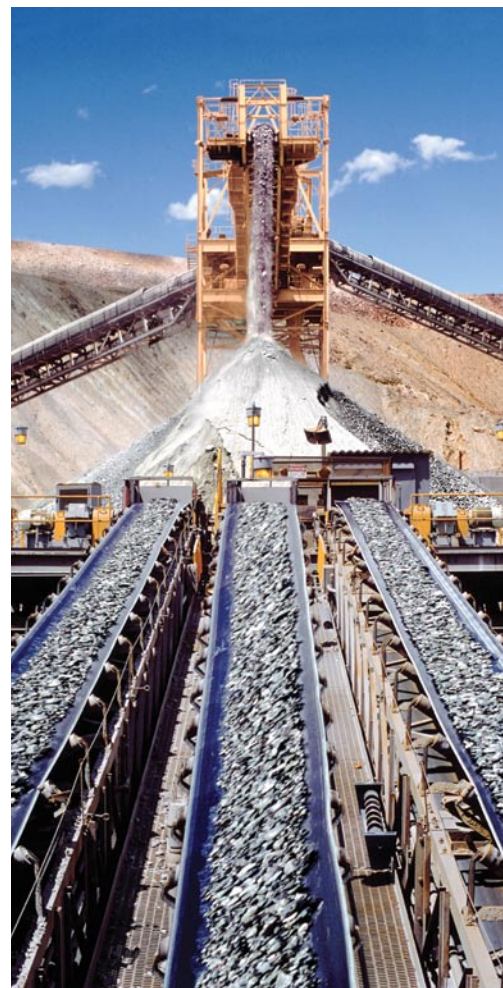
Tony Gibbons, Transaction Services
anthony.f.gibbons@ca.pwc.com
416 941 8241

Robert Scott, IT Effectiveness
robert.w.scott@ca.pwc.com
416 815 5221

Andy Wilczynski,
Performance Improvement
andy.wilczynski@ca.pwc.com
416 815 5091

Dan McPhee, Risk and Regulatory
daniel.mcphee@ca.pwc.com
416 941 8217

Ben Kaak, Diversified Industries
ben.kaak@ca.pwc.com
416 365 8858



Other IFRS resources

PricewaterhouseCoopers has published the following publications on International Financial Reporting Standards and corporate practices. They are available from your local PricewaterhouseCoopers office and can be found at www.pwc.com/ifrs.

- Real time – International Financial Reporting Standards in the mining sector
- Financial reporting in the mining industry
- IFRS Pocket Guide
- Financial instruments under IFRS
- IAS 39 – Achieving hedge accounting in practice
- IFRS Disclosure checklist 2006
- IFRS Measurement checklist 2006
- IFRS News – Shedding light on the IASB's activities
- Applying IFRS – PwC's authoritative guidance on the interpretation and application of IFRS. The interactive tool includes links to over 1,000 real-life solutions, as well as direct links to applicable text in the IFRS and interpretations.

www.pwc.com/ca/ifrs



