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# *2012 Americas School of Mines*

Update of IFRS for the Mining Industry

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# *Agenda*

Overview of IFRS Transition Year

IFRS Pronouncements - Effective Date Impacting 2012 Calendar Years

New IFRS Pronouncements and Updates

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# Overview of IFRS Transition Year

# *GAAP comparison of significant mining standards*

- Mine project lifecycle
  - Exploration
  - Development
  - Production
  - Closure

# *Exploration and Evaluation*

## IFRS 6: Exploration and Evaluation of Mineral Resources

Under *IFRS 6*, mining companies are allowed to retain their existing policies for the capitalization of exploration and evaluation costs until guidance that is more definitive is developed in this area. IFRS 6 also provides specific guidance on the facts and circumstances that indicate when a company should test exploration and evaluation assets for impairment, as well as the level at which these assets are assessed for impairment.

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | Capitalize resource property acquisition costs. Expense exploration and evaluation costs until proven and probable reserves as defined in SEC Industry Guide 7 are established. |

# *Exploration and Evaluation*

## Foreign Exchange

IFRS defines functional currency as the currency of the primary economic environment in which the entity operates.  Primary economic environment is normally the one in which the entity generates and expends cash. Primary indicators (currency of sales prices and costs) and secondary indicators (currency of financing activities and retention of receipts from operating activities) in *IAS 21* should be considered in the determination of the functional currency.

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | No hierarchy of indicators to determine functional currency. Where the functional currency is not obvious, management judgment of the currency that most portrays the primary economic environment of the entity's operation is used. |

# *Development*

The mining industry is characterized by projects that often have long commissioning periods, during which production is ramped up towards the design capacity. Differences between IFRS and US GAAP during this phase may include:

- Pre-production Costs (including borrowing costs)
- Property, Plant and Equipment
- Recognition of Decommissioning and Restoration Liabilities at each period end reflecting the disturbance caused to the site at that date

# *Development*

## IAS 16: Pre-Production Costs

IFRS costs can be recorded as PPE until the time when the asset is "available for use" as defined in *IAS 16 Property, Plant and Equipment* (capable of operating in the manner intended by management).

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | Start-up costs are expensed as incurred. |

# *Development*

## IAS 23: Borrowing Costs

IFRS under *IAS 23* borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalized as part of the cost of that asset.  A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Borrowing costs include interest expense, finance charges in respect of finance leases and exchange differences arising from foreign currency borrowings.

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | More judgment in the determination of the capitalization rate and US GAAP allows capitalization in relation to equity-method investments under certain circumstances. |

# *Development*

## IAS 16: Property, Plant and Equipment

IFRS under *IAS 16 PPE* is measured at cost and subsequently measured under either the cost model or the revaluation model.

- Cost model – PPE is carried at its cost less any accumulated depreciation.
- Revaluation model – PPE whose fair value can be measured reliably can be carried at a revalued amount.

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | No option to subsequently measure PPE under the revaluation model. |

# *Production*

During the production phase, many areas of accounting in a mining company require careful consideration under IFRS.

- Depreciation
- Deferred Stripping
- Impairment
- Joint Ventures
- Functional Currency
- Business Combinations

# *Production*

## Depreciation

IFRS requires that separate significant components of property, plant and equipment with different economic lives be recorded and depreciated separately. The guidance includes a requirement to review residual values and useful lives at each balance sheet date.

| GAAP | Different from IFRS | Description of Difference |
|---|---|---|
| US | Yes | US GAAP generally does not require the component approach for depreciation. |

# *Production*

## IFRS 11: Joint Arrangements

New IFRS pronouncement taking effect in 2013 removes the option of proportionate consolidation, requiring only the equity method as the single method of accounting for joint ventures.

| GAAP | Difference from IFRS | Description of Difference |
| --- | --- | --- |
| US | No | The entity must first be considered to determine if it is a VIE. Generally, only equity accounting is allowed. |

# *Production*

## IFRIC 20/IFRS 1: Stripping Costs in the Production Phase of a Surface Mine

IFRS has varied practices related to accounting for stripping costs. IASB has issued an Interpretation clarifying the requirements for accounting for stripping costs in the production phase of a surface mine.

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | All stripping costs incurred during production are included in the cost of inventory. |

# *Production*

## Long-lived Asset Impairment Testing

IFRS uses a one-step test. Assessment at end of each reporting peirod whether there is any indication that an asset is impaired. If any indicator exists, the asset shall be written down to its estimated recoverable amount (value in use or fair value less costs to sell). Reversal of an impairment is required when certain conditions are met (excluding goodwill).

| GAAP | Different from IFRS | Description of Difference |
|---|---|---|
| US | Yes | A two-step test is required under US GAAP. Reversals of impairment are prohibited. |

# *Production*

## Functional Currency

Primary and secondary indicators should be considered in the determination of the functional currency of an entity. If indicators are mixed and the functional currency is not obvious, management should use its judgment to determine the functional currency that most faithfully represents the economic results of the entity's operations.

| GAAP | Different from IFRS | Description of Difference |
|---|---|---|
| US | Yes | There is no hierarchy of indicators to determine the functional currency. |

# *Production*

## Business Combinations

All business combinations are accounted for using acquisition accounting, with limited exemptions. Acquisition accounting is applied to combinations between mutual entities and those achieved by contract alone.

| GAAP | Different from IFRS | Description of Difference |
|---|---|---|
| US | Yes | Combinations between mutual entities or those achieved by contract alone may not use acquisition accounting as it may not be appropriate. |

# *Closure*

## Mine Closure and Rehabilitation Provisions

IFRS recognizes provisions for both legal and constructive obligations. Obligations are re-measured at each reporting period, using prevailing assumptions, including updated pre-tax discount rate.

| GAAP | Difference from IFRS | Description of Difference |
|---|---|---|
| US | Yes | Recognize only legal obligations. Re-measure only incremental changes in the liability in the event of changes in the amount or timing of cash flows. Discount using the Company’s credit-adjusted risk-free interest rate. |

# IFRS Pronouncements - Effective Date Impacting 2012 Calendar Years

# *2011 Pronouncements*

## IFRS 1: Exemption for Severe Hyperinflation and Removal of Fixed Dates

Amended to create additional exemptions:

(i) For when an entity subjected to severe hyperinflation resumes presenting, or presents for the first time, financial statements in accordance with IFRS. The exemption allows an entity to elect to measure assets/liabilities at fair value and use that fair value as deemed cost.

(ii) To eliminate references to fixed dates (January 1, 2004 and October 25, 2002 and replace with "the date of transition of IFRS's") for one exception and one exemption, both dealing with financial assets and liabilities.

# *2011 Pronouncements*

## IFRS 7: Financial Instruments – Disclosures

Amended to require additional disclosures related to risk exposures arising from transferred financial assets. Currently, *IFRS 7* requires entities to disclose certain information about transferred financial assets that are not derecognized in their entirety.

The amendment will retain these disclosures, and include transactions that may not have been subject to the original disclosure requirements.

Effective for annual periods commencing on/after July 1, 2011.

## IAS 12: Deferred Tax Accounting for Investment Property at Fair Value

*IAS 12* requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. Amended to introduce an exception to the measurement of deferred tax assets or liabilities arising on investment property measured at fair value using the fair value model, in accordance with *IAS 40, Investment Property*.

This exception is based on a rebuttable presumption that the carrying value of the investment property can be recovered entirely through sale.

Effective for annual periods commencing on or after January 1, 2012.

# *2012 Pronouncements*

## IAS 1 – Presentation of Items of Other Comprehensive Income ("OCI")

IAS 1 is amended to include a requirement to group together items within OCI that may be reclassified to the profit or loss section of the income statement. Existing requirements are still in place where items presented in OCI and profit or loss should be presented in a single statement or two consecutive statements.

Effective for years commencing on or after July 1, 2012.

# New IFRS Pronouncements and Updates

# *2013 Pronouncements*

## IAS 19: Employee Benefits

IAS 19 is amended to reflect:

- Significant changes to the recognition and measurement of defined benefit pension expense and termination benefits to improve the accounting standard by:
  - Eliminating an option to defer the recognition of gains and losses, known as the 'corridor method', improving comparability and faithfulness of presentation.
  - Streamlining the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring re-measurements to be presented in other comprehensive income.

# *2013 Pronouncements*

## IAS 19: Employee Benefits (continued)

- Expanded disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation.

Effective for years commencing on or after January 1, 2013.

# *2013 Pronouncements*

## IFRS 1: First Time Adoption of IFRS – Accounting for Government Loans

The proposed amendment sets out how a first-time adopter would account for a government loan with a below-market rate of interest upon transition to IFRS.

If adopted, this amendment would provide full relief for first time adopters from full retrospective application of IFRS  in relation to accounting for government loans on transition. This is the same relief as was given to existing preparers of IFRS financial statements.

The amendments are mandatory for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

# *2013 Pronouncements*

## IFRS 7: Financial Instruments – Disclosures

Amended to enhance disclosures to help investors and other financial statement users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. The enhanced disclosure requirements relate to offsetting financial assets and liabilities.

Offsetting, otherwise known as netting, is the presentation of assets and liabilities as a single net amount in the statement of financial position (balance sheet).

Companies and other entities are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The required disclosures should be provided retrospectively.

# *2013 Pronouncements*

## IAS 32: Financial Instruments – Presentation

Amended to clarify requirements for offsetting of financial assets and financial liabilities.

# *2013 Pronouncements*

## IFRIC 20/IFRS 1: Stripping Costs in the Production Phase of a Surface Mine

IASB has issued an Interpretation clarifying the requirements for accounting for stripping costs in the production phase of a surface mine. The interpretation states that to the extent that the benefit from the stripping activity is improved access to ore, these stripping costs are added to the existing asset, if the criteria the below criteria are met:

- It is probable that the future economic benefits related to the stripping will flow to the entity
- The entity can identify the component of an ore body for which access has been improved
- The costs relating to the improved access to that component can be measured reliably

## IFRIC 20/IFRS 1: Stripping Costs in the Production Phase of a Surface Mine (continued)

Where costs cannot be specifically allocated between the inventory produced during the period and the stripping activity asset, the interpretation requires an entity to use an allocation basis that is based on a relevant production measure.

# *2013 Pronouncements*

## IFRS 10: Consolidated Financial Statements

Replaces the guidance on control and consolidation in *IAS 27 – Consolidated and separate financial statements*. *IFRS 10* builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

The change to this standard will require significant judgment from management to determine which entities are controlled, but will assist in determining control when it is difficult to determine.

*IFRS 10* may affect insurers with interests in funds, structured entities, unit linked assets and liabilities or control of specified assets.

# *2013 Pronouncements*

## IFRS 11: Joint Arrangements

IFRS 11 *Joint Arrangements* provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case).

Proportionate consolidation is no longer permitted, and now must be accounted for using the equity method. The standard addresses inconsistencies in the reporting of joint arrangements by requiring a single method to account for interests in jointly controlled entities.

## IFRS 12: Disclosure of Interests in Other Entities

IFRS 12 sets out improved disclosure requirements for subsidiaries, joint ventures, associates and “structured entities.” IFRS 12 replaces the requirements previously included in IAS 27, IAS 31, and IAS 28 *Investments in Associates,* as they overlapped.

The IFRS requires an entity to disclose information that enables users of financial statements to evaluate:

- the nature of, and risks associated with, its interests in other entities; and
- the effects of those interests on its financial position, financial performance and cash flows.

# *2013 Pronouncements*

## IFRS 13: Fair Value Measurement and Disclosure Requirements

Provides a single source of guidance on how to measure fair value where its use is already required or permitted by other IFRS. It defines fair value, displays an IFRS framework for measuring fair value, and then requires disclosures regarding fair value measurements.

Fair value hierarchy disclosures are extended to non-financial assets and liabilities measured at fair value. Enhanced disclosure requirements:

- Information about non-recurring fair value measurements introduced

## IFRS 13: Fair Value Measurement and Disclosure Requirements (continued)

- Effect on profit or loss for recurring fair value measurements categorized within Level 3
- Information about fair value disclosed for items not measured at fair value but for which fair value is disclosed
- More detail in interim financial statements for fair value of financial instruments

# Upcoming IFRS Projects

# *Joint Projects of FASB and IASB*

## Revenue Recognition

Revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRS), and both sets of requirements need improvement.

FASB and IASB initiated a joint project to clarify the principles for recognizing revenue from contracts and to develop a common revenue standard for U.S. GAAP and IFRS that would:

- remove inconsistencies and weaknesses in existing revenue recognition standards by providing clear principles for revenue recognition in a robust framework

# *Joint Projects of FASB and IASB*

## Revenue Recognition (continued)

- provide a single revenue recognition model which will improve comparability over a range of industries, companies and geographical boundaries
- simplify the preparation of financial statements by reducing the number of requirements to which preparers must refer.

Target date 2012-2013, but unlikely to become effective until 2014+

# *Other Ongoing IASB Projects*

## Insurance contracts

Aiming at providing a single source of principle-based guidance to account for all types of insurance contracts.

## Consolidation: Investment entities

Aiming to define an investment entity and to require that an investment entity should not consolidate investments in entities that it controls, but to measure those investments at fair value, with changes in fair value recognised in profit or loss.

## Leases

Developing a new single approach to lease accounting that would ensure that all assets and liabilities arising under lease contracts are recognised in the balance sheet.

# *Other Ongoing IASB Projects*

## Replacement of IAS 39 – Financial Instruments -with IFRS 9

Improve the usefulness of financial statements for users by simplifying the classification and measurement requirements for financial instruments. Three phases:

1. **Classification and measurement**: working together to seek to reduce differences in the respective classification and measurement models for financial instruments.
2. **Impairment methodology:** improving the amortised cost measurement, in particular the transparency of provisions for losses on loans and for the credit quality of financial assets.
3. **Hedge accounting:** improving the usefulness of financial statements for users by fundamentally reconsidering the current hedge accounting requirements.

The mandatory effective date of IFRS 9 is deferred to annual periods beginning on or after 1 January 2015. Early application of IFRS 9 will continue to be permitted.

# *Changes under IFRS for Financial Instruments*

| | |
|---|---|
| Classification & Measurement | •IFRS 9: Financial Instruments: Mixed Measurement approach based on business model and financial asset characteristics<br>•Financial Liabilities Exposure Draft: Fair Value Options |
| Fair Value Measurement | •Clarifies the definition of fair value and enhances disclosures |
| Hedge Accounting | •Aim to simplify requirements<br>•May replace fair value hedge accounting with an approach similar to cash flow hedge accounting |
| Derecognition | •A single approach to derecognition based on control |
| Impairment | •Incurred loss replaced with expected cash flow approach<br>•Earlier recognition of credit losses |
| Others | •Interactions with other developments, such as consolidation and insurance contracts |

# *Extractive Activities Project*

**Currently paused until IASB concludes its future work plan**

- Harmonized global reserves / resources definitions
- All exploration, evaluation and subsequent development expenditures are capitalized when legal right to explore is acquired
- More onerous and detailed disclosures required (current or fair values of reserves and resources, production revenues by commodity, disaggregated costs summaries)

# *Issues arising from the application of IFRS in Canada*

## IFRS 3 and IAS 12: Uncertain tax positions acquired in a business combination

- Are any uncertain tax positions in business combinations measured at fair value or in accordance with IAS 12? IFRS 3 requires measurement of assets acquired or liabilities assumed at fair value.
- However, an exception exists which requires deferred tax assets and liabilities arising from assets acquired or liabilities assumed in the business combination to be accounted for in accordance with IAS 12.

# *Issues arising from the application of IFRS in Canada*

## IFRS 3 and IFRS 13: Measuring the fair value of debt assumed in a business combination

- Upon adoption of IFRS 13, provisions must be applied to all fair value measurements, including debt assumed in a business combination. IFRS 13 requires a quoted price in an active market to be used to determine fair value.
- When listed debt is assumed in a business combination, the price of the debt may change to reflect the market's expectations regarding changes to non-performance risk that may result from the pending acquisition (e.g. acquirer's credit standing, synergistic benefits etc).
- This issue considers whether any adjustment can appropriately be made to a quoted price of acquired debt, and also considers what principles should be applied to measure the fair value of debt that is not publicly listed.

# *Issues arising from the application of IFRS in Canada*

## Going concern language in SEC filings

- For companies that file with the SEC and that also have going concern note disclosure in their financial statements, PCAOB rules and SEC requirements specify wording in the audit report. PCAOB guidance prohibits the use of conditional language such as "may" and requires the phrase "substantial doubt".
- Additionally, IAS 1 requires disclosure in the financial statements of the uncertainties that "may cast significant doubt" upon an entity's ability to continue as a going concern.
- Potentially creating an inconsistency between the disclosures made by management in the financial statements and the wording of the audit report required by the SEC.

## *Issues arising from the application of IFRS in Canada*

### IAS 16: Useful Life of Leasehold Improvements

- A company enters an operating lease for office space and spends amounts on leasehold improvements. The definition of "lease term" under IAS 17 includes lease renewal options only when it is "reasonably certain" that the option will be taken.
- However, the period for depreciation of the leasehold improvements is defined under IAS 16 as being the "expected" useful life.
- The IDG discussed whether the expected useful life of the leasehold improvements could be longer than the lease term as defined under IAS 17.

# *Issues arising from the application of IFRS in Canada*

## IAS 17 and IAS 40: Initial direct leasing costs for investment properties measured using the fair value model

- The IDG discussed the question of whether initial direct costs of setting up a lease relating to an investment property measured using the fair value model should be amortized separately over the lease term, or considered part of the investment property that is measured at fair value.

# *Where can I find more information?*

To find more information please visit www.pwc.com/ifrs

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