

Accounting and Financial Reporting in Mining

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Agenda

New standards/interpretations for 2013

- Joint arrangements
- Stripping costs
- Consolidation

On going standard setting activity

- Leasing
- Hedge accounting
- Revenue

Others

- Extractive activities project
- SEC progress on IFRS adoption
- Other areas of focus

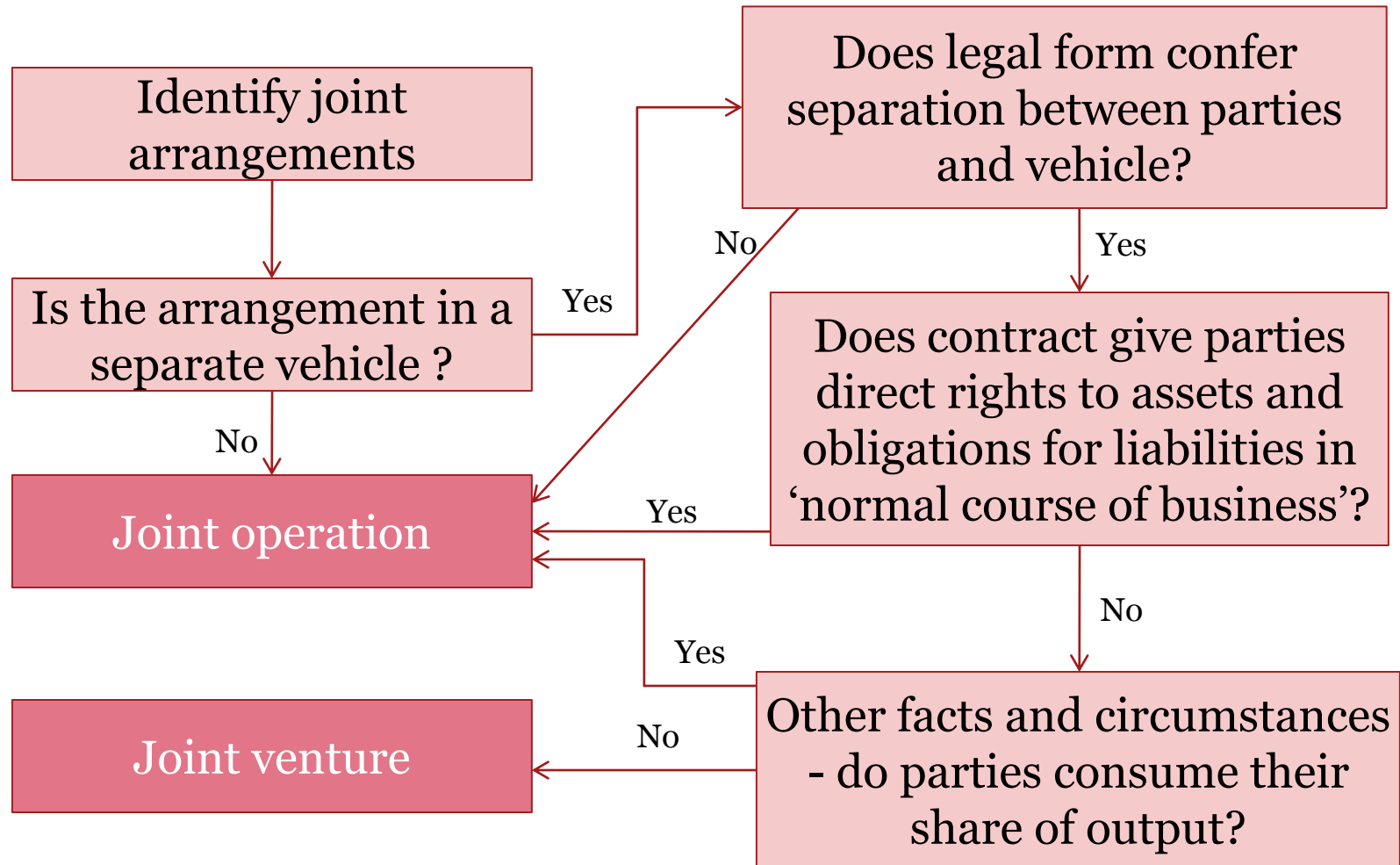
Recap: Types of joint arrangements

Joint control

- contractually agreed sharing of control
- unanimous consent over 'relevant activities'

IAS 31 types	IFRS 11 types	Contractual rights and obligations	Accounting
Jointly-controlled assets	Joint operations	Rights to assets; liabilities for obligations	Own/ Share of assets, liabilities, revenue, expenses
Jointly-controlled operations			
Jointly-controlled entities		Rights to net assets	Equity accounting (proportionate consolidation not allowed)
	Joint ventures		

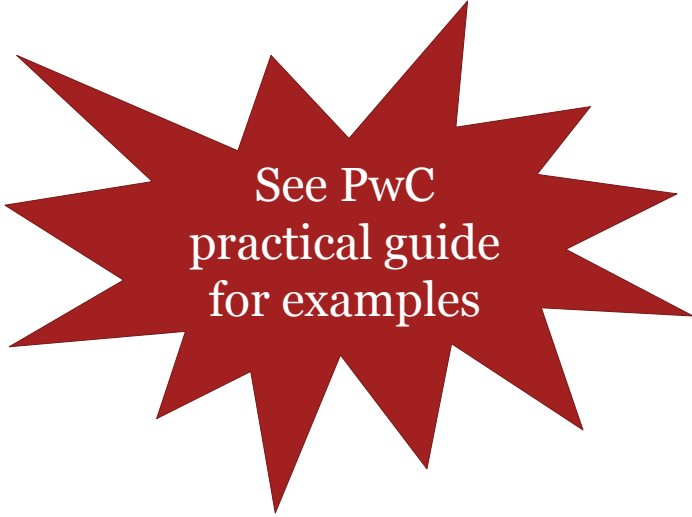
Recap: Classification



Classification

Legal form of separate vehicles

- Many types of separate vehicles:
Partnerships, unincorporated entities, limited companies, unlimited liability companies, etc.
- Legal form may not provide for separation
- Joint operation if no legal separation



See PwC
practical guide
for examples

Contractual terms

- Contractual terms may reverse /modify legal form
- Consider only rights and obligations in ‘normal course of business’
- Liquidation and bankruptcy rights less relevant

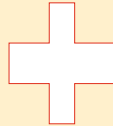
Focus on ‘other facts and circumstances’

Assess purpose and design of arrangement

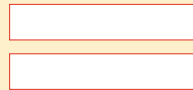
Operation set up to provide all output to venturers?

Yes

Rights to all economic benefits from assets



Dependence on venturers for cash → obligation for liabilities



JOINT OPERATION

Focus on ‘other facts and circumstances’

Some complexities

Output readily saleable in market

- Important factor to consider – but not conclusive
- If venturers are obligated to take the output – most likely a joint operation
- Reassess if facts and circumstances change

Pricing of product – how relevant?

- Important factor to consider – but not conclusive
- If venturers are obligated to take the output– most likely a joint operation
- Does not have to operate at break-even level

Focus on ‘other facts and circumstances’

Some complexities

Arrangement borrows money independently – how relevant?

- Important factor to consider – but not conclusive
- If venturers are obligated to take the output – arrangement continues to be dependent on parties for funds to repay borrowings and interest

Varying levels of output taken by venture partners each year

- Assess intent of setting up the arrangement
- Assess economics– how does it correlate to investment by venture partners
- Assess impact on share of assets/liabilities

IFRS 11 Joint Arrangements

Thinking ahead ...

1

Impact on
processes and
systems

- Extensive analysis of all existing and future contracts for the existence of separable rights and obligations to be classified as joint operations or joint ventures, particularly any old, poorly documented arrangements
- Legal form will be less important in classification
- May need to change from equity accounting or proportionate consolidation

IFRS 11 Joint Arrangements

Thinking ahead ...

2

Impact on
financial
statements
and key financial
ratios

- Application of the equity method leads to a balance sheet contraction and a substantial change in the profit or loss structure, e.g. revenues
- May also impact covenants, capital ratios and other performance measures like EBIT or EBITDA
- Share of profit of a jointly controlled entity is generally no longer shown under operating results

Stripping costs

Scope

Includes	Excludes
Production phase stripping costs	Pre-production stripping costs
Surface mining activity	Underground mining activity

Oil sands

- Whether oil sands extraction is surface mining - not addressed
- Entities in oil sands extraction using processes similar to surface mining – to assess carefully whether included in scope

Development phase vs. production phase

- No guidance on differentiating development from production phase
- Can be complex requiring significant judgement especially where portions of large mines are accessed in stages

Stripping costs

Recognition of stripping costs as an asset

Benefit from stripping activity	Accounting
Production of usable ore (Inventory)	In accordance with IAS 2 Inventories
Improved future access to ore	As an stripping activity asset if: <ul style="list-style-type: none">• Probable future economic benefits• Can be identified to a specific component for which access improved• Costs can be measured reliably

- Stripping activity asset is part of an existing asset. Classification as tangible or intangible depends on classification of the existing asset
- Identifying components is a complex process involving significant management judgement – consider mine plans, annual production plans, push back campaigns, etc
- Prolonged push back periods may result in significant amounts being capitalised - careful attention and judgement necessary

Stripping costs

Initial measurement

- Stripping activity asset is measured at cost - includes directly incurred costs and allocation of directly attributable overheads
- Principles of IAS 16/IAS 38 followed while determining the costs that can be capitalised

Can costs be separately identified for inventory and stripping activity asset?

Yes

Record both assets at respective costs

No

Allocate costs based on a relevant production measure

- Allocation of costs cannot be based on a sales measure
- Some relevant production measures are:
 - ✓ Cost of inventory produced vs. expected cost;
 - ✓ Volume of waste extracted vs. expected volume; and
 - ✓ Mineral content of the ore extracted vs. expected mineral content

Stripping costs

Worked example – Allocation of costs

Entity X had the following cost and extraction information for an identified component of its gold mine:

Direct costs incurred for the stripping activity	CU 10,550,000
Directly attributable overhead costs	CU 3,450,000
Total	CU 14,000,000
Ore extracted in the current year	765 tonnes
Waste extracted in the current year	5,980 tonnes
Total	6,745tonnes
Expected ore to be extracted from component	4,590 tonnes
Expected waste to be extracted from component	28,750 tonnes
Total	33,340 tonnes

How should X allocate the costs incurred between the inventory produced and the stripping activity asset?

Stripping costs

Worked example – Allocation of costs

Step 1: Can X identify the costs separately for each of the benefits?

Let us say X has determined that it **cannot** separately determine the costs because inventory and stripping activity asset are produced simultaneously.

Step 2: Determine a production measure that can be used to allocate costs

X has determined that they will allocate costs based on the volume of waste extracted compared with expected volume, for a given volume of ore production.

A different production-measure based allocation of costs can be used.

If the mineral content fluctuates significantly or cost of production is a more reliable measure, those basis can be chosen to allocate costs if it gives the most relevant and reliable information

Stripping costs

Worked example – Allocation of costs

Step 3: Determine the additional waste extracted compared to expected volume of waste for the actual volume of ore extracted

Expected waste per unit of ore produced

Expected vol. of ore to be extracted
Expected vol. of waste to be extracted
= 28,750/4,590 = 6.26

Expected vol. of waste for actual vol. of ore produced

= 765 * 6.26 = 4,791.67

Actual volume of waste extracted

= 5,980

Additional waste extracted

= 5,980 – 4,791.67 = 1,188.33

Stripping costs

Worked example – Allocation of costs

Step 4: Work out the ratio for allocating costs to the stripping activity asset

$$\begin{aligned}\text{Ratio} &= \frac{\text{Additional volume of waste extracted}}{(\text{Actual volume of waste} + \text{ore extracted})} &&= \frac{1,188.33}{(5,980 + 765)} \\ &&&= 17.62\%\end{aligned}$$

The ratios at Step 3 and 4 above have to be computed for a specific component of the ore body and not the mine as a whole.

Step 5: Compute the amount to be allocated to inventory and the stripping activity asset

Allocation to stripping activity asset = $14,000,000 \times 17.62\%$ = **2,466,800**

Allocation to inventory = $14,000,000 - 2,466,800$ = **11,533,200**

Stripping costs

Subsequent measurement of stripping activity asset

- Measured consistently with existing asset of which it is a part
- At cost or revaluation less depreciation/amortisation and impairment
- Depreciated/amortised over expected useful life of identified component of ore body – generally UOP basis
- Expected useful life of a component is shorter than that of mine itself – exception when stripping activity provides improved access to whole of remaining ore body - example, at the end of mine's useful life
- Impairment determined as per IAS 36. Tested for impairment as part of the relevant CGU and not on standalone basis.

Stripping costs

Transition and effective date

- Apply to stripping costs incurred on or after beginning of earliest period presented
- Opening balances to be linked to components of ore for which access was improved
- If no such ore remains / can be identified, write off against opening retained earnings
- Effective date: Annual periods beginning on or after 1 January 2013
- Early adoption permitted, if disclosed

IFRIC 20 Stripping costs

Thinking ahead ...

1

Impact on
processes and
systems

- Review processes used to gather underlying data
- Implementation may be expensive given increased involvement of management and data gathering exercise

IFRIC 20 Stripping costs

Thinking ahead ...

2

Impact on
financial
statements
and key financial
ratios

- Potential change in accounting policy and timing of expense recognition
- Existing asset balances that cannot be attributed to an identifiable component of the ore body will need to be written off to retained earnings

Consolidation – Effect analysis

Are there new consolidation requirements?



Will there be more or less consolidation?

Who will be most impacted?

- **Similar underlying principals**
- **Adds additional context and application guidance**
- **IFRS 10 will change the way control is assessed – focus on all three elements of control**

Consolidation – Effect analysis

Are there new consolidation requirements?

Will there be more or less consolidation?

Who will be most impacted?

- **Most consolidation decisions may be unaffected**
- **May result in more consolidation or de-consolidation depending on bright lines applied under IAS 27/SIC 12**
- **Will result in more appropriate consolidation**

Consolidation – Effect analysis

Are there new consolidation requirements?

Will there be more or less consolidation?

Who will be most impacted?



- **Control without a majority of voting rights**
- **Potential voting rights**
- **Agency relationships**
- **Financing entities**

What is control?

Control

Power

What activities significantly affect returns (“relevant activities”)?



How are decisions about relevant activities made?



Do investor’s rights provide current ability to direct relevant activities?



Exposure or rights to variable returns



Ability to use power to affect returns

Principal/agent assessment

Lease accounting proposals

What is the status?

- Expect revised exposure draft in Q1 2013
- No date for final standard yet – earliest application date 1 Jan 2015

What are the impacts?

- Current proposals may result in earlier expense recognition, higher liability recognition and more income statement volatility

What should entities do?

- Assess impacts, especially where renegotiating long-term compliance and performance targets in financing arrangements

Hedge accounting proposals

What is the status?

- Review draft of standard issued in September 2012 for a fatal flaw review
- Final standard expected late 2012 – earliest application date 1 January 2015

What are the impacts?

- Hedge accounting qualification requirements will be relaxed – more hedges will be eligible for hedge accounting
- More items can be hedged and used as hedging instruments

Hedge accounting proposals

What are the major changes?

- Easier hedge effectiveness test
- Hedging of components possible
- Permits hedging of net positions
- Reduces P&L volatility for hedging with options
- Voluntary revocation of hedge designation not permitted

Hedge accounting proposals

What should entities do?

- Early adoption may be beneficial though significant transitional challenges
 - Removal of arbitrary 80-125% bright line; fewer failed hedge relationships
 - Alignment to risk management policies
 - Accounting will better reflect “economic” outcome
 - Allows for hedging of components
 - Removes a possible impediment to hedging with options

Revenue proposals

What is the status?

- IASB and FASB currently discussing responses to the second ED
- Final standard expected 2013 – application date 1 Jan 2015 or later

What are the impacts?

- Principal based approach – link to contractual performance obligations

What should entities do?

- Monitor developments

Extractive activities project - paused since July'10

Matters researched	Key recommendations
Definition of reserves and resources	Oil & gas – PRMS Minerals – CRIRSCO template
Recognition of an asset relating to mineral/O&G reserves	Initial recognition on acquisition of legal rights to explore Over time this asset is enhanced by: <ul style="list-style-type: none">✓ information from E&E activities✓ development to access minerals or oil & gas✓ additional rights and approvals Unit of account evolves from the exploration rights to the field
Measurement of the asset	Historical cost
Information to be disclosed about reserves and resources	Reserves <ul style="list-style-type: none">✓ Quantities: proved and probable, changes✓ Disaggregate by risk: commodity, geography✓ Key inputs: assumptions, sensitivities✓ Value? Other disclosures <ul style="list-style-type: none">✓ Financial disclosures✓ Publish what you pay

SEC Staff's IFRS Work Plan: The Journey

February 2010

SEC publishes a statement of continued support for a single set of high-quality, globally accepted accounting standards, and acknowledged that IFRS is best positioned to serve that role.

2010

October 2010

The first Work Plan progress report issued.

It included a routine update on the Staff's work to date, with no indication of the SEC's direction.

July 2011

SEC Staff sponsored roundtables to discuss benefits and challenges of potentially incorporating IFRS into the financial reporting system for US issuers.

2011

May 2011

SEC Staff releases a paper describing a possible method to incorporate IFRS into the US financial reporting system

- US GAAP would remain
- Active endorsing /interpreting FASB
- Incorporation over 5-7 years
- Early adoption not discussed

July 2012

SEC Staff completes IFRS Work Plan

- Important milestone in journey to single set of high-quality, globally accepted accounting standards
- No final decision made on whether, when, and how IFRS may be incorporated in the US financial reporting system
- Voluntary adoption not discussed
- No timeline of next steps provided

2012

November 2011

SEC Staff released two papers, pursuant to the SEC staff's IFRS Work Plan.

- Consistency of IFRS application
- Remaining IFRS/FASB framework differences

SEC Staff IFRS Work Plan: The highlights

- Adopting IFRS as authoritative guidance in the US is not supported by the vast majority of participants in the US capital markets and would not be consistent with the methods of incorporation followed by other major capital markets
- Substantial support for exploring methods (such as endorsement) of incorporating IFRS that demonstrate the US commitment to the objective of a single set of high-quality, globally accepted accounting standards
- Does not include a final decision on whether, when, or how IFRS should be incorporated in the US financial reporting system
- No timeline of when this decision will be made, nor next steps necessary to make this decision were discussed in final report
- Does not address whether US public companies should be allowed to adopt on a voluntary basis

Other areas of focus

- Impairment considerations
 - ✓ Consideration of triggers - current market factors
 - ✓ Determination of CGUs
 - ✓ Which assets can be grouped into a single CGU?
 - ✓ Discount rates and prices moving up
- Discount rates
 - ✓ Closure provisions discounted using a pre-tax rate that reflects current market assessments of time value of money
 - ✓ Entities with multi-national operations should select an appropriate discount rate for locations with materially different risks

Other areas of focus

- Segment reporting
 - ✓ Identifying the CODM
 - ✓ Aggregation of segments – constant criticism by regulators

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