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A Practical Guide to ISAK 29

Stripping costs in the production phase of a surface mine

What is the issue?

ISAK 29, 'Stripping costs in the production phase of a surface mine', sets out the accounting for overburden waste removal (stripping) costs in the production phase of a mine. The interpretation applies to financial statements for periods beginning on or after 1 January 2014. The interpretation may require mining entities to write off existing stripping assets to opening retained earnings if the assets cannot be attributed to an identifiable component of an ore body. The interpretation may also require entities that presently allocate their stripping costs entirely to production costs to revisit their approach and capitalize a portion of their costs. This interpretation is based on IFRIC 20, issued by the International Accounting Standards Board. The interpretation amends the current "life-of-mine average" approach promulgated under Indonesian Statement of Financial Accounting Standards (PSAK) 33 (Revised 2011) "Stripping Activities and Environmental Management in General Mining".

The interpretation will likely require mining companies to spend significant time and effort in reassessing their current accounting for deferred stripping, and perhaps even require changes to systems for collecting financial and non-financial information related to mine plan execution.

Understanding the tax implications of changing the approach to stripping accounting will also be key, as there are currently no specific tax rules in relation to stripping costs, and as such the tax treatment will likely follow the accounting standard.

Miners are encouraged to consider the implications of the change in accounting treatment driven by ISAK 29 well before the implementation date of 1 January 2014 to ensure adequate information is available to properly assess the required changes, and to consider implications on profitability, tax deductions and financial and non-financial systems.

The experience of IFRS reporters (for which IFRIC 20 has been applicable since 1 January 2013) shows that a significant investment of time is required to properly address the changes, and that the implications for profitability and balance sheet amounts is significant.

Objective and scope

Stripping costs incurred once a mine is in production often provide benefits for current production and access to future production. The challenge has always been how to appropriately allocate the benefits and then determine what the period costs are versus an asset that will benefit future periods. Historically, some entities have treated all stripping costs as a cost of production, while other entities have capitalized some portion of stripping costs as an asset.

ISAK 29 applies only to stripping costs that are incurred in surface mining activity during the production phase of the mine. It does not address underground mining activity.

The transitional requirements of the interpretation may have a significant impact on a mining entity that has been using an average life-of-mine ratio to record deferred stripping. Existing asset balances that cannot be attributed to an *identifiable component of the ore body* will need to be written off to retained earnings.

Key provisions of ISAK 29

1. Is the definition of an asset met?

Stripping activity may create two types of benefits: (i) inventory produced; and (ii) improved access to the ore. An entity should assess whether the benefits of the stripping activity fall within either of those categories. The benefit of improved access to the ore will qualify as a non-current "deferred stripping" asset only when:

(a) it is probable that the future economic benefit (improved access to the ore body) associated with the stripping activity will flow to the entity;

(b) the entity can identify the component of the ore body for which access has been improved; and

(c) the costs relating to the improved access to that component can be measured reliably.

2. When should the asset be recognized?

Stripping costs that relate to inventory produced should be accounted for as a current production cost in accordance with PSAK 14, 'Inventories'. Stripping costs that generate a benefit of improved access and meet the above definition of an asset should be accounted for as an addition to or enhancement of an existing asset (stripping activity asset); it is not an asset in its own right. The capitalized costs are classified as tangible or intangible according to the nature of the existing asset.

3. How should the stripping activity asset be measured initially?

The stripping activity asset should initially be measured as the direct costs are incurred. These costs include haulage, waste transportation, materials consumed, costs of machinery employed, labour and fuel. An allocation of directly attributable overhead costs may also be made. It may be difficult to separate the costs incurred that create the future benefit (stripping activity asset) and the costs related to current period inventory production. Entities will allocate total costs between the inventory produced and the stripping activity asset using a relevant production measure.

The production measure is calculated for the identified component of the ore body and used to identify the extent to which the additional activity has created an asset. ISAK 29 provides examples of such measures, including volumes of waste extracted compared with expected volumes for given production levels. Entities currently using 'stripping ratios' may find that the new requirements are similar to their existing approach, although the basis of the ratio will be life of the identified component, rather than the full life-of-mine.

4. How should the stripping activity asset be measured subsequently?

The stripping activity asset is carried at cost or revalued amount, less depreciation or amortization and impairment losses. The asset is depreciated or amortized in a rational and systematic manner over the useful life of the relevant identified component of the ore body. This is expected to be shorter than the useful life of the mine in most cases. The units-of-production method is applied unless another method is more appropriate.

Key practical matters in adopting this interpretation

1. **Determining the component of the ore body**

   There are a number of factors that will need to be considered when determining the component for which access has been improved, including the nature of the commodity (for example, bulk commodities like coal will have very different mining characteristics than base minerals), the number of pits within a mine site and also whether multiple cut-backs are planned over the life of the mine. This is an area that involves significant judgment as there are different approaches to extract the underlying mineral deposits depending on the specific geological conditions of each mine and the entity's mine planning strategies.

2. **Involvement of non-finance staff**

   Making an appropriate assessment on identifying the components or ore body will require finance staff seeking the view of the company's mining department to understand how they view components of ore and efforts to ensure improved access to these components. We have seen for IFRS reporters that a review of mine plans conducted by both finance and mining personnel together to address this interpretation is an effective way to identify the most appropriate component.

3. **Recently acquired mines**

   With the requirement for companies to be able to allocate existing stripping assets to identified components of the ore body, mining companies with recent acquisitions should ensure appropriate documentation is in place to enable these assets to be carried forward. It may be challenging to carry forward legacy stripping assets from prior acquisitions conducted years ago for long-lived mines if the documentation is not readily available.

Am I affected?

All surface mining entities will be affected by the interpretation. The interpretation applies to financial statements for periods beginning on or after 1 January 2014. Any existing deferred stripping cost asset balances at the date of transition are written off to opening retained earnings unless they can be shown to relate to *an identifiable component of the ore body*. That means for reporting entities preparing 31 December 2014 financial statements, the assessment will have to be done as of 1 January 2013. Assessment at an earlier date will be necessary if additional comparatives are presented.

An entity that has been expensing all production period stripping will begin capitalizing from the date of adoption of the interpretation, if and only if the stripping costs meet the criteria for deferral under the interpretation.

We understand that with the implementation of ISAK 29, the Indonesian Accounting Standards Board intends to withdraw PSAK 33, and accounting for environmental management in the mining industry will need to refer to other standards, such as PSAK 16 "Fixed Assets" or PSAK 57 "Provisions, Contingent Liabilities and Contingent Assets".

Please contact your usual PwC mining contact, or the contributors overleaf, with any queries or requests for assistance in implementation of ISAK 29.

4. **Tax considerations**

   The tax impact of ISAK 29 implementation will need to be investigated, particularly for companies that have adopted the current "life-of-mine average" approach under PSAK 33. Areas to consider will include:

   - If there is a write off of an existing stripping asset on 1 January 2014, will this need to be applied retroactively or can the amount be deducted directly in 2014?

   - That the tax law provides specific rules on depreciation or amortisation, which may be different from the accounting rules.

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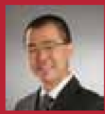
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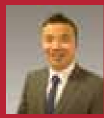
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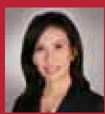
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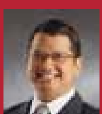
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