FASB Emerging Issues Task Force

Issue No. 04-6

Title: Accounting for Stripping Costs Incurred during Production in the Mining Industry

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References:

FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements* (FAS 3)

FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies* (FAS 19)

FASB Concepts Statement No. 6, *Elements of Financial Statements* (CON 6)

APB Opinion No. 20, *Accounting Changes* (Opinion 20)

AICPA Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 4, "Inventory Pricing" (ARB 43)

AICPA Accounting Research Bulletin No. 45, *Long-Term Construction-Type Contracts* (ARB 45)

AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1)

Securities Act Industry Guide 7, *Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations* (Industry Guide 7)

IAS ED 6, *Exploration and Evaluation of Mineral Resources* (IAS ED 6)

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* **The alternative views presented in this Working Group Report are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination and it is ratified by the Board.**

International Accounting Standards Committee, *An Issues Paper Issued for Comment by the IASC Steering Committee on Extractive Industries* (IASC Issues Paper)

Background

1. In the mining industry, companies may be required to remove overburden and other mine waste materials while accessing mineral deposits. The costs of removing overburden and waste materials are referred to as "stripping costs." During the development of a mine (before production begins) it is generally accepted in practice that stripping costs are capitalized as part of the depreciable cost of building, developing, and constructing the mine. These capitalized costs are typically amortized over the productive life of the mine using the units of production method. A mining company may continue to remove overburden and waste materials, and therefore incur stripping costs, during the production stage of the mine. It is the accounting for stripping costs incurred during production that has resulted in questions being raised as to the appropriate accounting for those costs, and now diversity in practice exists.

2. The question of accounting for stripping costs is a difficult issue to address because stripping costs incurred during production may benefit both future periods (that is, the nature of the cost is the same or similar to stripping costs incurred in the development phase) and current period production. Until the last unit of reserves is extracted from a mine, some believe that all stripping costs incurred in a mining operation have an element of future benefit, as the removal of the overburden and waste material allows the entity to gain access to additional reserves.

3. In practice, many mining companies estimate the total material to be mined throughout the mine's productive life. Those companies, using a long-term mine plan, then develop a "life of mine stripping ratio," or a "stripping ratio," which is calculated as the estimated total waste material tons mined during production divided by the estimated total proven and probable reserves contained within the mine (that is, recoverable ore in a unit of measure, for example, pounds of copper or ounces of gold). Diversity in the mechanical calculation of the stripping ratio and the life of mine concept currently exists in practice. However, irrespective of those differences, the result of using a stripping ratio and the deferred stripping accounting model is consistent; the allocation of a ratable amount of stripping costs (incurred during the production phase) to each unit of reserves extracted from the mine.

4. Because the physical concentration of mineral deposits is not uniform throughout a mine, a company generally is mining a ratio of waste material to mineral deposits that is different from the stripping ratio. Refer to Exhibit 04-6A for an illustration of a cross section of a mine and a calculation of a deferred stripping ratio. For each period, the actual stripping ratio is compared to the life-of-mine stripping ratio. If the actual stripping ratio exceeds the life-of-mine stripping ratio (that is, more waste is removed than the estimated average), the excess stripping cost that was incurred is recognized as a deferred stripping asset. Alternatively, if the actual stripping ratio is less than the life-of-mine stripping ratio (that is, less waste is removed than the estimated average), the shortfall is recognized as a reduction in the deferred stripping asset. In certain limited cases, the shortfall is recognized as a deferred credit on the balance sheet (when the deferred stripping asset, if any, does not absorb the amount of the shortfall). Changes in the average life-of-mine stripping ratio are accounted for prospectively as changes in estimates. This method of accounting for stripping costs incurred during production may be used in practice in circumstances in which the stripping ratio is expected to vary substantially over the life of the mine. In other situations, entities may expense stripping costs as incurred during production when the stripping ratio over the life of a mine is expected to be relatively stable.

Scope

5. This Issue applies to mining entities. Mining entities include entities involved in finding and removing wasting natural resources—other than oil- and gas-producing entities that are within the scope of FAS 19.

Definition of the Production Phase

6. This Issue applies to the accounting for stripping costs incurred in the *production phase* of a mining operation. It is often difficult to determine when development or construction of the mine has ended and the production phase has begun. Industry Guide 7 defines the production stage as the stage that "includes all issuers engaged in the exploitation of a mineral deposit (reserve)." For purposes of defining the scope of this Issue, a further definition of the production phase of a mine is warranted. That definition is as follows:

The production phase of a mine is deemed to have begun once operations have commenced and revenue is realized from the sale of minerals, irrespective of the level of production.

Prior Task Force Discussion

7. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed the accounting for stripping costs incurred during production but did not reach a consensus. The Task Force asked the FASB staff to further explore and develop with the Mining Industry Working Group (Working Group) the following alternatives: (a) expense as incurred, (b) include in inventory as a variable production cost, and (c) defer as an asset (no liability recognition) and recognize in earnings using a proportional performance ratio. These alternatives have been put forth in this Working Group Report as Views A, B, and C, respectively. The Task Force also requested the FASB staff to solicit a recommended view from the Working Group.

8. On August 19, 2004 the FASB staff held a meeting of the Working Group to further discuss and develop the alternatives and to form a Working Group recommendation as to the accounting for stripping costs incurred during production, as well as the recommended transition alternative. At that meeting the Working Group discussed Views A, B, and C, as well as an alternative view that is included herein as View D. The Working Group developed the View D approach after further consideration of the practice issues associated with Views A, B, and C, as well as consideration of the discussion of the Task Force at its June 30-July 1, 2004 meeting. Input obtained from the Working Group and the Group's recommendations have been incorporated into this Working Group Report.

9. To assist the Task Force in understanding the impact of reaching a consensus on the alternative views, the FASB staff has prepared an analysis of the expected change to the current practice of accounting for stripping costs incurred during production under two basic mining scenarios. The analysis has been prepared for informational purposes only and is not intended to be prescriptive of the current or future accounting for any specific sector or entity within the mining industry. That analysis is included as Exhibit 04-6B.

Accounting Issues and Alternatives

Issue 1: How stripping costs incurred during production in the mining industry should be accounted for.

View A: Stripping costs incurred during the production phase of a mine should be expensed as incurred.

10. Proponents of View A believe that once a mine begins production, all subsequent costs to remove materials from the mine are costs of current production. Some proponents hold the view that stripping costs incurred during production are costs incurred to maintain current production and, while a necessary cost of extracting the unrefined product from the mine, provide little future economic benefit to be obtained or controlled by an entity. Accordingly, View A proponents believe that costs incurred to conduct stripping activities during production do not meet the definition of an asset as contemplated by CON 6 and therefore must be expensed as incurred.

11. Some proponents of View A believe that stripping costs incurred during production primarily benefit current production, but they also acknowledge that those activities could provide benefits to future periods (that is, some element of the stripping costs is a development cost). However, because it is difficult to accurately allocate stripping costs between those that benefit current production and those that benefit future periods, as a practical expedient, View A proponents believe immediate recognition as an expense is appropriate. That view is consistent with other areas within U.S. GAAP, such as paragraph 25 of SOP 98-1, which states that when an entity cannot distinguish whether a cost should be capitalized or expensed as incurred, the default treatment is for the cost to be expensed as incurred.

12. Proponents of View A observe that the occurrence of mineral deposits often is not uniform throughout a mine. In those cases, it is expected that there will be periods in which more minerals or fewer minerals are produced. View A proponents believe that the inconsistency in stripping costs associated with the amount of reserves being mined during a period should be recognized in the operating results of the mining entity.

13. Proponents of View A also are concerned that deferring stripping costs incurred during production and recognizing the stripping costs at a uniform rate over the life of the mine (refer to View C) results in smoothing of earnings such that the financial statements do not accurately reflect economic reality. If costs are incurred unevenly, then the financial statements should reflect that economic reality, rather than being smoothed through the use of a matching methodology.

14. Opponents to View A believe that it is inappropriate to attribute all of the costs to remove waste material to the period of removal, as the removal of the waste material clearly has an element of future benefit. The opponents believe that a portion of the stripping cost relates to current period activities, but in some cases (depending upon the geological structure of the mine) the majority of the cost to remove the waste is an additional development cost that provides the entity access to future reserves. They argue that those costs are similar in nature to initial development costs. The opponents believe that attributing all of the stripping costs to the current period would not be representationally faithful as it does not capture the true economics of the reserves extracted and sold in the current period (that is, if the mining entity was only concerned with extracting the reserves in the current period, it may choose not to produce the reserves extracted in that period as they may not be economically recoverable). For the same reasons, these opponents believe View A does not capture the true economics of the reserves extracted and sold in future periods.

View B: Stripping costs incurred during the production phase of a mine are a variable production cost that should be considered a component of mineral inventory cost subject to the provisions of ARB 43.

15. Proponents of View B believe that after a mine begins production; all subsequent costs to remove materials from the mine are costs of current production and therefore represent a component of the inventory cost of the minerals being extracted. These proponents do not acknowledge that stripping costs incurred in production benefit future periods and thus represent a development cost. Chapter 4, Statement 3, of ARB 43 states that "the primary basis of

accounting for inventories is cost…. As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location." View B proponents believe that the costs incurred to remove waste material are a direct cost incurred to bring the mineral reserves to a condition and location that provides the future value to the entity.

16. View B proponents hold the view that the unit of account to be considered in determining the appropriate accounting for stripping costs incurred during production, is the minerals extracted in a given period and not the total minerals extracted over the life of the mine (the view point of View C proponents). Consistent with that notion, stripping costs incurred in a given period should be associated with the activities of that period, including the mineral inventory extracted, giving no consideration to the benefits that may be provided to the future activities of the mine.

17. View B proponents point out that since entities engaged in mining activities are not exempt from the provisions of ARB 43, all costs of producing the reserves should, therefore, be considered costs of the extracted minerals under a full absorption costing system and recognized as a component of costs of sales in the same period as the related revenue from the sale of the minerals.

18. View B proponents emphasize that the discussion section for Statement 3 of ARB 43 states that "…under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges rather than as a portion of the inventory cost." View B proponents believe that mining entities should consider this guidance in determining whether stripping costs in a reporting period are so abnormal as to require treatment as a period charge and not a component of the cost of the minerals extracted.

19. View B proponents believe that the same methods should be used for accounting for production costs in the mining industry as are used in other industries where inventories are

produced and sold for a profit. As such, production costs for a period should be attributable to the inventory produced during that period.

20. Opponents to View B (consistent with the opponents to View A) believe that it is inaccurate to attribute all of the costs to remove waste material for a given period to the mineral inventory extracted for the period, as the removal of the waste material clearly has an element of future benefit. These opponents believe that a portion of the stripping cost in a given period does relate to current production but that, in some cases (depending upon the geological structure of the mine), the majority of the cost to remove the waste may be akin to a development cost as its primary purpose is to allow the entity to access additional reserves. These opponents believe that associating all of the stripping costs to production in the current period would not be representationally faithful as it does not capture the true economics of the reserves extracted in the current period (that is, if the mining entity was only concerned with extracting the reserves in the current period, it may choose not to produce the reserves extracted in that period as they may not be economically recoverable).

View C: Stripping costs incurred during the production phase of a mine should be deferred and recognized in earnings using a stripping ratio, subject to not recognizing a liability in periods when the actual stripping ratio is less than the estimated average stripping ratio for the mine.

21. Proponents of View C acknowledge that stripping costs incurred during production may have elements of both mine development costs and production costs. However, the proponents also acknowledge the difficulty in identifying the development and production components of the cost and, therefore, support View C as it attempts to capture and account for the development component using a stripping ratio and the deferred stripping accounting model. Under a View C approach, actual stripping costs incurred in production in excess of the average stripping ratio for the mine are capitalized as development costs and recognized in future periods when the actual stripping ratio is less than the average stripping ratio. Stripping costs not capitalized as a development cost are recognized as a production cost of the period incurred. View C proponents believe that in addressing the accounting for stripping costs incurred during production, the unit of account should be the mine. Using that as a basis, proponents of View C believe that applying

a stripping ratio to recognize stripping costs ratably over the life of the mine results in a practical and reasonable allocation of those costs to the associated revenue from the minerals extracted from the mine.

22. Proponents of View C note that stripping costs incurred during production are necessary costs that will be continually incurred over the life of the mine. They believe that a portion of the stripping activities during the production phase represent the continuous development of the mine as they allow future access to additional reserves as minerals are mined. For that reason, View C proponents see little difference between pre-production and production stripping activities and, therefore, hold the view that stripping costs capitalized as development costs should be accounted for on a similar basis (that is, recognized in the income statement ratably over the life of the mine).

23. For periods in which actual waste material removed exceeds the estimated average waste over the life of the mine, proponents of View C believe it is appropriate to recognize an asset (that is, an additional investment in the mine) as the costs for the excess material moved represent a probable future economic benefit to be realized by the extraction of ore in subsequent periods. To further support the recognition of an asset, View C proponents emphasize that the fair value of a partially developed ore body, where waste material has already been removed, would be greater than a comparable ore body where little or no waste material had been removed (that is, the ore body is more valuable as a result of the removal of waste because access to future reserves becomes easier and less costly).

24. Proponents of View C believe that stripping costs deferred on the balance sheet as an asset meet the characteristics of an asset as defined by CON 6. They point to paragraph 26 of CON 6, which defines the essential characteristics of assets as:

> (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
> (b) a particular entity can obtain the benefit and control others' access to it, and
> (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

Since removal of waste material is required to allow the entity to gain access to additional reserves that are economically recoverable in the future, View C proponents believe that the cost to remove the waste material embodies a probable future benefit that, in combination with the other assets of the mine, contributes directly to the future net cash inflows of the enterprise. Further, with regard to characteristic (b), View C proponents hold the view that the mining enterprise has valid rights to access and mine the reserves in a specified area and, therefore, controls the benefit (and others' access to it) obtained from the stripping activity. The costs incurred to undertake the stripping activity that results in the recognition of an asset have "already occurred." Therefore, View C proponents believe that characteristic (c) has also been satisfied.

25. In contrast, for periods in which actual waste material tons moved is below the normalized waste material tons moved determined by applying the stripping ratio, View C proponents do not believe it is appropriate to recognize a deferred stripping cost liability. Paragraph 35 of CON 6 states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (footnote references omitted). View C proponents believe that under no circumstances would the accounting for stripping costs under this method create an obligation of the entity to transfer assets or provide services in the future. Therefore, an entity accounting for stripping costs under this method would not incur a liability as defined under CON 6.

26. Proponents of View C further believe that expensing all stripping costs once production has begun results in unnecessary volatility in reported production costs and earnings as the products being mined are produced from sections of the mine where ore concentrations may be more or less than the expected average over the life of the mine. They believe investors would be confused by widely varying production costs from period to period and that comparability of operating results between companies would be impaired if stripping costs were not deferred after production began. Proponents of View C note that deferral of post production stripping costs is a

long-standing industry practice, and they believe it more appropriately portrays the long-run cost structure of producing the minerals.

27. In contrast, opponents to View C note that the determination of the production stripping ratio is subject to significant subjectivity. That subjectivity arises from the need to estimate both waste material to be removed and proven and probable reserves over potentially long periods of time (that is, the life of the mine). Because the ratio needs to be adjusted as additional data becomes available, the use of the life-of-mine stripping ratio also creates opportunities for manipulation of earnings that could cause investors and others to question the reliability of financial reporting in this industry. Supporters of View C disagree with this argument as they contend that the legal and regulatory requirements in the mining industry require an entity to obtain very precise estimates of both reserve levels and estimated life-of-mine waste material before substantive mining operations can begin. Those estimates are subject to revision on a prospective basis as more information is obtained and operations commence. Supporters of View C argue that significant effort is put into determining and updating these estimates, such that opportunities for earnings manipulation are mitigated, since significant adjustment to initial estimates would be thoroughly scrutinized. Supporters of View C also note that the estimates of waste materials to be removed over the life of the mine are similar to other estimates that are required to be made throughout the life of the mine (for example, estimates of recoverable reserves and estimates of asset retirement obligations).

28. The FASB staff believes that if a consensus is reached on View C, certain presentation and disclosure issues should be addressed. Specifically, the accounting for stripping costs under this View attempts to capture the development component of the stripping costs through the application of the life of mine stripping ratio. Therefore, as mentioned above, the deferral of costs under this model represents a development cost that should be reflected on the balance sheet as additional investment in the mine. The prior practice of reporting the deferred stripping costs as a separate asset on the balance sheet should be prohibited. The FASB staff believes that a View C consensus should also be accompanied by specific disclosure requirements. These requirements are discussed below in the Disclosures section of this Working Group Report as they pertain to both a View C and a View D consensus.

29. The FASB staff further believes that under a View C consensus, the Task Force should require an entity to specifically attribute deferred stripping costs incurred during production to proved reserves that benefit from those stripping activities. For example, an entity may be required to develop multiple stripping ratios for a single mine if the multiple reserves in the mine are distinct and if certain stripping activities can be identified to benefit only certain sections of the mine or specific reserves. Effectively, an entity would be required to consider whether there is a lower level of accounting unit than the entire mine to calculate its stripping ratio(s). Further, the Task Force should acknowledge that an entity that estimates a uniform stripping ratio over the life of the mine (or specifically identified reserves) may recognize stripping costs as a production cost.

View D: Stripping costs incurred during production are a mine development cost that should be capitalized as an investment in the mine and attributed to proved reserves benefited in a systematic and rational manner.

30. Proponents of View D believe that stripping costs incurred during production are a cost incurred to gain access to reserves and therefore represent an additional development cost that should be capitalized as part of the cost of the mine. These proponents believe that stripping costs incurred during the production phase represent continuous development of the mine as they allow access to additional sources of reserves as waste and reserves are extracted from the mine. For that reason, View D proponents hold the view that all stripping costs represent mine development costs that should be accounted for on a consistent basis irrespective of whether the costs are incurred during initial mine development or during production.

31. View D proponents support the capitalization of stripping costs incurred during production by analogy to FAS 19. Paragraph 21 of FAS 19 states, in part, that "Development costs are incurred to obtain access to proved reserves…." Paragraph 22 of FAS 19 states, in part, that "Development costs shall be capitalized as part of the cost of an enterprise's wells and related equipment and facilities." View D proponents believe that stripping costs incurred in the production phase of a mine are a "development cost incurred to obtain access to proved reserves"

and, therefore, those costs should be capitalized as part of the cost of an enterprise's mine consistent with treatment of development costs under FAS 19. Opponents of View D believe that the stripping costs incurred during production are production costs, and they note that FAS 19 requires production costs to be included in the costs of the inventory produced.

32. To further support the capitalization of the stripping costs as an asset, View D proponents emphasize that the fair value of a partially developed ore body, where waste material has already been removed, would be greater than a comparable ore body where little or no waste material has been removed (that is, the ore body is more valuable as a result of the removal of waste because access to future reserves becomes easier and less costly). Consistent with proponents of View C, View D supporters believe that stripping costs should be capitalized on the balance sheet as an asset (additional investment in the mine) as the costs incurred to remove the waste material meet the characteristics of an asset as defined by CON 6. Like proponents of View C, View D supporters also point to paragraph 26 of CON 6 for a definition of the essential characteristics of assets.

33. Since removal of waste material is required to allow the entity to gain access to additional reserves that are economically recoverable in the future, View D proponents believe that the cost to remove the waste material embodies a probable future benefit that, in combination with the other assets of the mine, contributes directly to the future net cash inflows of the enterprise. Further, with regard to characteristic (b), View D proponents hold the view that the mining enterprise has valid rights to access and mine the reserves in a specified area and, therefore, controls the benefit (and others' access to it) obtained from the stripping activity. The costs incurred to undertake the stripping activity that results in the recognition of an asset have "already occurred." Therefore, View D proponents believe that characteristic (c) has also been satisfied.

34. View D proponents believe that stripping costs capitalized as part of an enterprise's investment in the mine should be allocated to the mined reserves in a systematic and rational manner. These proponents acknowledge that the method of attributing the capitalized stripping cost to the reserves mined may differ from mine to mine or from mineral to mineral, including

mines owned or controlled by the same entity. Further, View D proponents acknowledge that stripping costs incurred in the production phase of the mine may be attributed to the reserves extracted from the mine in a different manner than stripping costs incurred during the development phase (stripping costs capitalized during the development of the mine typically are amortized on a units-of-production basis). That difference is supported by the fact that stripping costs incurred during the development phase (prior to accessing any reserves) may be deemed to benefit the mine in its entirety. In contrast, while it may be determined that stripping costs incurred during the production phase benefit the mine in its entirety, it may also be determined that the stripping costs benefit only a portion of the total reserves being mined, thus supporting variation in the attribution model for stripping costs incurred in different phases of the mine.

35. View D proponents believe that the method of attributing the stripping costs to reserves extracted is determined based on the individual facts and circumstances associated with the mine and, therefore, differing methods and rates of attribution would be appropriate under differing scenarios. Further, these proponents acknowledge that a systematic and rational approach of allocating the stripping costs to reserves extracted does not preclude an entity from capitalizing an amount of stripping costs (development cost) and attributing an equal amount to reserves extracted in the same period.

36. To further illustrate application of View D, consider the following examples:

> **Example A:** Coal Company owns and operates a coal mine that extracts coal from an open pit mine. The coal reserves are in a horizontal seam that is relatively close to the surface. The effort required to mine the coal (remove the overburden and extract the coal) is consistent from period to period. That is, the coal reserve being extracted is found in a consistent seam and the overburden removed is directly associated with specific reserves extracted. Mining of the coal is a continuous activity of removing overburden and replacing overburden to reclaim portions of the mine.
>
> **Evaluation:** The stripping costs associated with the removal of overburden in the production phase to expose the coal is a development cost that should be capitalized as an addition to the investment in the mine and attributed to the coal reserves benefited in a systematic and rational manner. Since the stripping costs incurred are directly attributable to that period's production, Coal Company capitalized the stripping costs and attributed the same amount to that period's production. Coal Company would not have the option of

deferring those costs to future periods as the stripping costs can be attributed to specific reserves.

Example B: Gold Company owns and operates an open pit gold mine. Because of the location and shape of the ore deposit containing the related reserves, the gold will not be mined at a uniform rate over the life of the mine. Accordingly, the stripping costs incurred during production will be incurred in a non-uniform manner. Gold Company expects the life of the mine to be 10 years, and management estimates that 500,000 ounces of gold will be extracted over the life of the mine.

Evaluation: The stripping costs associated with the removal of overburden in the production phase to expose the gold is a development cost that should be capitalized as an addition to Gold Company's investment in the mine and attributed to the gold reserves benefited. Since Gold Company cannot specifically attribute the stripping costs to specific gold reserves, the stripping costs should be attributed to extracted gold in a systematic and rational manner over the life of the mine. Gold Company may use a units-of-production method, a stripping ratio, or another systematic and rational method to attribute stripping costs incurred during production.

37. Opponents to View D believe that accounting for stripping costs incurred during production under this View will not eliminate the diversity in practice that currently exists. Further, these proponents believe that allowing for various attribution models of the capitalized stripping costs allows entities to select an attribution model that may not be representative of the economics of the mining operation. In particular, these proponents are concerned that selecting a units-of-production amortization method may result in a mining entity recognizing "artificially high" operating margins in the early years of a mine's life. Under that method the margins would gradually decrease over time, thus resulting in the entity recognizing "artificially low" gross margins toward the end of a mine's productive life, which ultimately may result in an impairment of the mine before reaching the end of its productive life. Proponents to View D believe that those concerns are alleviated by the fact that under View D, a mining enterprise would select an attribution model that appropriately reflects the economics of the mine throughout its economic life.

38. Opponents to View D also cite the financial reporting issues surrounding the change in reporting of stripping costs in the income statement and statement cash flows (see discussion below) as a significant concern under the View D model.

Working Group Recommendation

39. The Working Group recommends View D. The Working Group believes that stripping costs incurred during production are development costs that should be recognized as an additional investment in the mine. The Working Group believes that View D offers a conceptually sound model, while at the same time providing flexibility to permit the model to be applied to the myriad of mining scenarios that exist within the industry.

Potential Financial Reporting Issues

40. The FASB staff would like to acknowledge two financial reporting issues with implementing a consensus on View D (the working group recommendation), which also occur with implementing a consensus on View C, that surfaced as a result of the Working Group's discussions. The first issue relates to the required change in reporting of stripping costs in the statement of cash flows, which results from the conclusion that all or a portion of the stripping costs incurred during production are development costs, and, therefore, capital expenditures. The second issue is similar and relates to a change in the display (geography) in the income statement resulting from the conclusion that all or a portion of the stripping costs are development costs and, therefore, would be included in depreciation, depletion, and amortization (DD&A), as opposed to costs of sales, in the income statement.

41. With respect to the reporting of stripping costs in the statement of cash flows, irrespective of the current method employed to account for stripping costs incurred during production, mining enterprises report the cash effects of the stripping activities as operating activities within the statement of cash flows. Under a View D or View C consensus, mining entities will be required to include those costs, or at least a portion of those costs under View C, as an investing activity (mine development costs) with an increase in operating cash flows through an increase in "depreciation, depletion and amortization."

42. Under current practice, the income statements of most mining entities report costs of sales and DD&A as two separate components of operating costs. Stripping costs incurred in production are typically reported as a component of costs of sales irrespective of the method

used to account for the stripping costs. Under a View D consensus, stripping costs would be included in the entity's investment in the mine and therefore recognized as a component of DD&A in the income statement. Under a View C consensus, the same issue would arise for those stripping costs capitalized as development cost under the stripping ratio model. Accordingly, a significant change in the reporting of those captions within the income statement would occur on a going forward basis.

43. The FASB staff acknowledges that those financial reporting changes are significant for mining entities but believes that the cash flow and income statement characterizations outlined above would be required under the premise that stripping costs, or at least some portion of those stripping costs in the case of a View C consensus, incurred during production are a cost of developing the mine and, therefore, should be reported in the same manner as all other costs to develop the mine. If a View D or a View C consensus is reached, the FASB staff does not believe that further action is required to address those concerns (see discussion of transition below).

Disclosure

44. The Working Group and FASB staff believe that a View D or a View C consensus should be accompanied by the following required disclosures: (a) the accounting policy for stripping costs incurred during production, in particular the method and assumptions used to defer and amortize those stripping costs and the amounts related to each method, as applicable, (b) the amount of deferred stripping costs included in property, equipment, and mine development (or comparable balance sheet caption) at each balance sheet date, (c) the amount of stripping costs attributed to production and the amount recognized in the income statement during each period that an income statement is presented, and (d) the estimated useful life of capitalized stripping costs.

Transition

45. Current practice on the accounting for stripping costs incurred in production is diverse. It is apparent that there are a number of entities applying the accounting under variations of the Views put forth above. Given the significant costs associated with stripping activities for a mining entity, reaching a consensus on this Issue will result in a significant change in accounting

for certain entities. Accordingly, if a consensus is reached on this Issue, the FASB staff believes that the Task Force should consider transition alternatives. The alternative transition provisions to be considered are as follows:

View A: The guidance in this consensus shall be effective for financial statements issued for fiscal years beginning after December 15, 2004, with early adoption permitted. An entity shall recognize the cumulative effect of initially applying this consensus in accordance with the provisions of APB 20. Entities that elect to early adopt the guidance in this consensus during an interim period, shall report the effects of this change in interim financial statements in accordance with the provisions of FAS 3. To the extent necessary, balance sheet amounts previously reported are required to be reclassified for all years presented to conform to the presentation required by this consensus.

46. Proponents of View A believe that the change in financial reporting resulting from a consensus on this Issue will have significant effects on the financial statements of certain entities. Accordingly, these proponents believe that reporting the effect of a significant change in accounting principle is most effectively accomplished through the reporting of a cumulative effect adjustment, with pro-forma disclosures to highlight the effects of retroactive application of the consensus on previously issued financial statements. An effective date of fiscal periods beginning after December 15, 2004, is proposed to allow entities adequate time to prepare for the adoption of the consensus guidance in this Issue.

47. These proponents believe that transition under View A is only viable if a View A or View B consensus is reached on Issue 1. They believe that it would be impractical to determine the cumulative effect adjustment under certain mining scenarios if a View C or View D consensus is reached on Issue 1. In particular, these proponents cite the difficulty in determining the cumulative effect under a View C or View D consensus in those circumstances under which the mines may have been in operation for long periods of time.

View B: The guidance in this consensus shall be applied for fiscal periods beginning after December 15, 2004, with earlier application permitted. The effects of applying this guidance *shall be reported by retroactive restatement of prior period financial statements in accordance with paragraphs 27 and 28 of APB 20.*

48. Proponents of View B agree with proponents of View A and believe that the change in accounting resulting from this consensus will be a significant change in practice for certain mining entities. However, View B proponents believe the advantages of restating prior periods (that is, comparability in financial reporting amongst entities in the mining industry) outweigh the disadvantages, and, therefore, mandatory restatement of prior period financial statements would be the preferable transition alternative. An effective date of fiscal periods beginning after December 15, 2004, is proposed to allow entities adequate time to prepare for the adoption of the consensus guidance in this Issue.

49. Opponents to View B agree that a consensus on this Issue will be a significant change in practice for certain mining entities, specifically when considering the financial reporting issues addressed in View D of Issue 1, above. Furthermore, they agree that better financial reporting would result from a restatement of prior year financial statements to conform to the reporting required by this consensus. However, these opponents believe that re-creating the financial statements in prior years to conform to a consensus on any of the Views in this Issue would be impractical and virtually impossible in some circumstances. Accordingly, opponents to this view believe that the costs of requiring restatement would far outweigh any perceived benefits.

View C: The guidance in this consensus shall be effective for stripping costs incurred in fiscal periods beginning after the date of Board ratification of the consensus. Recognition of a cumulative effect in accordance with the provisions of APB 20 and FAS 3 would not be permitted, except in the case where an enterprise had previously recognized a liability pursuant to a deferred stripping accounting policy. In that case, the liability should be de-recognized and recognized as a cumulative effect of an accounting change in accordance with APB 20 and FAS 3. Amounts previously recognized as deferred stripping assets are required to be reclassified to property, equipment, and mine development (or comparable balance sheet caption), for all years presented and accounted for in accordance with the guidance in this consensus on a prospective basis. Where practicable, income statements and statements of cash flows should be reclassified *for all years presented to conform to the presentation required by this consensus. Restatement of prior period financial statements to conform to the guidance in this consensus is permitted but not required.*

50. Proponents of View C believe that prospective transition is acceptable for a change of this nature. However, they believe that this is a viable transition alternative only if the Task Force reaches a consensus on View C or View D, as a consensus on View A or View B would have the effect of prolonging the deferral of past stripping costs, in certain cases, over extended periods (thereby, prolonging the diversity in practice that currently exists).

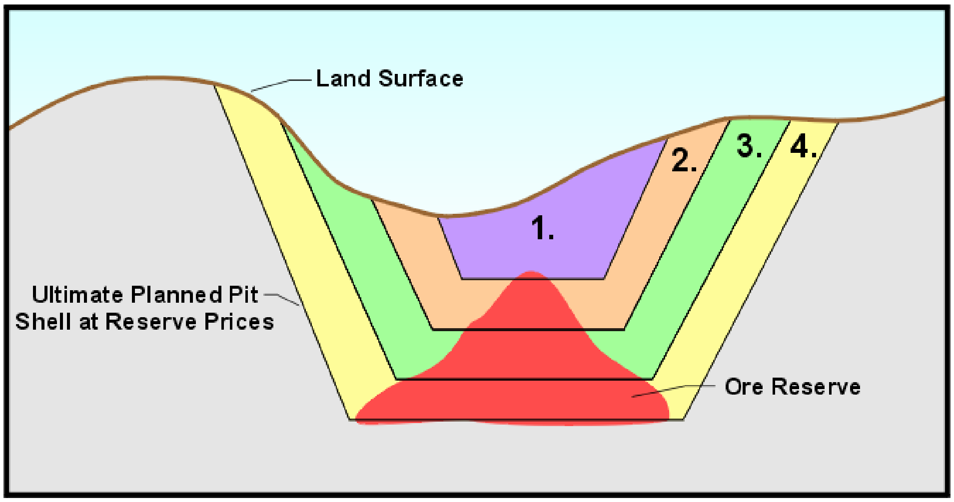
51. Proponents of View C also believe that restatement of prior period financial statements to conform to the guidance in this consensus in those circumstances when it is practical and results in improved financial reporting should be permissible.

Working Group Recommendation

52. If the Task Force reaches a consensus on View D of Issue 1 (Working Group recommendation), the Working Group recommends the transition for this consensus presented in View C.

EXHIBIT 04-6A

CROSS SECTION OF A MINE AND CALCULATION OF A DEFERRED STRIPPING COST RATIO



		Waste/Ore Stripping Ratio	
•	Year 1	-	Initial stripping-all waste material (capitalized)
•	Year 2	6:1	Stripping ratio is high as waste material is removed to reach lower portions of the ore body
•	Year 3	3:1	Stripping ratio is slightly lower as the ore body is being accessed
•	Year 4	2:1	Stripping ratio is low as most waste was removed in prior phases
•	Life-of-Mine	3:1	

EXHIBIT 04-6B

ANTICIPATED IMPACT OF ACCOUNTING FOR STRIPPING COSTS INCURRED UNDER THE VIEWS PRESENTED UNDER TWO BASIC EXAMPLE MINING SCENARIOS

To assist the Task Force in understanding the impact of reaching a consensus on the alternative views, the FASB staff has prepared the following analysis of the expected change to the current practice of accounting for stripping costs incurred during production under two basic mining scenarios. The analysis has been prepared for informational purposes only and is not intended to be prescriptive of the current or future accounting for any specific sector or entity within the mining industry.

Example A: Coal Company owns and operates a coal mine that extracts coal from an open pit mine. The coal reserves are in a horizontal seam that is relatively close to the surface. The effort required to mine the coal (remove the overburden and extract the coal) is consistent from period to period. That is, the coal reserve being extracted is found in a consistent seam and the overburden removed is directly associated with specific reserves extracted. Mining of the coal is a continuous activity of removing overburden and replacing overburden to reclaim portions of the mine.

Example A Assumptions: For purposes of this example it is assumed that Coal Company currently accounts for stripping costs incurred during production as a cost of current production and typically does not stockpile inventory.

View A: Stripping costs incurred during the production phase of a mine should be expensed as incurred.

Evaluation: Since Coal Company does not stockpile inventory, it is expected that accounting for stripping costs incurred during production (hereinafter referred to as Stripping Costs) under View A would result in only a minimal change in current practice.

View B: Stripping costs incurred during the production phase of a mine are a variable production cost that should be considered a component of mineral inventory cost subject to the provisions of ARB 43.

Evaluation: Accounting for Stripping Costs under View B is the current practice for Coal Company. Therefore, a consensus on View B would not have an impact on Coal Company's financial reporting.

View C: Stripping costs incurred during the production phase of a mine should be deferred and recognized in earnings using a stripping ratio, subject to not recognizing a liability in periods when the actual stripping ratio is less than the estimated average stripping ratio for the mine.

Evaluation: It is assumed that the effort to mine the coal is consistent from period to period (that is, the life of mine stripping ratio is consistent from period to period), therefore it is expected that a View C consensus would have only a minimal impact on Coal Company's current practice as it could also be assumed that the life of mine stripping ratio does not vary from the actual stripping ratio from period to period. However, as discussed in the Working Group Report, the classification of stripping costs within the income statement and the reporting of cash activities within the cash flow statement may be significantly impacted.

View D: Stripping costs incurred during production are a mine development cost that should be capitalized as an investment in the mine and attributed to proved reserves benefited in a systematic and rational manner.

Evaluation: It is assumed that the effort to mine the coal is consistent from period to period, therefore it is expected that under a View D consensus the capitalized costs would be attributed to proved reserves benefited in a systematic and rational manner that would mirror accounting for the costs as a production cost. That assumption would be supported by the fact that the stripping costs can be specifically associated with reserves extracted and therefore would be attributed to those specific reserves. Under that assumption, it is expected that the accounting for Stripping Costs under View D would result in a minimal or no change in Coal Company's results from operations. However, as discussed in the Working Group Report, the classification of stripping costs within the income statement and the reporting of cash activities within the cash flow statement may be significantly impacted.

Example B: Gold Company owns and operates an open pit gold mine. Because of the location and shape of the ore deposit containing the related reserves, the gold will not be mined at a uniform rate over the life of the mine. Accordingly, the stripping costs incurred during production will be incurred in a non-uniform manner. Gold Company expects the life of the mine to be 10 years and management estimates that 500,000 ounces of gold will be extracted over the life of the mine.

Example B Assumptions: For purposes of this example it is assumed that Gold Company currently accounts for stripping costs incurred during production using a deferred stripping accounting model, which has no prohibition on the recognition of a liability in periods when the actual stripping ratio is less than the life of mine stripping ratio. Assume further that Gold Company does not typically stockpile inventory.

View A: Stripping costs incurred during the production phase of a mine should be expensed as incurred.

Evaluation: In this example, Stripping Costs are incurred in a non-uniform manner over the life of the mine. Since Gold Company's current accounting policy results in the attribution of a uniform amount of Stripping Costs to each unit of reserves extracted from the mine, accounting for Stripping Costs under a View A consensus would be a significant change in practice for Gold Company and would result in income statement volatility.

View B: Stripping costs incurred during the production phase of a mine are a variable production cost that should be considered a component of mineral inventory cost subject to the provisions of ARB 43.

Evaluation: In this example, Stripping Costs are incurred in a non-uniform manner over the life of the mine. Since Gold Company's current accounting policy results in the attribution of a uniform amount of Stripping Costs to each unit of reserves extracted from the mine, accounting for Stripping Costs under a View B consensus would also be a significant change in practice for Gold Company and would result in income statement volatility. Since Gold Company does not typically stockpile inventory, it expected that accounting for Stripping Costs under View B would be similar to the accounting required under a View A consensus.

View C: Stripping costs incurred during the production phase of a mine should be deferred and recognized in earnings using a stripping ratio, subject to not recognizing a liability in periods when the actual stripping ratio is less than the estimated average stripping ratio for the mine.

Evaluation: Gold Company currently accounts for Stripping Costs under a manner that is similar to View C, with the exception of the prohibition on liability recognition. Therefore, it is expected that a View C consensus would result in a change in practice for Gold Company only to the extent that it had previously recognized a liability related to stripping costs incurred during production. However, as discussed in the Working Group Report, the classification of stripping costs within the income statement and the reporting of cash activities within the cash flow statement may be significantly impacted.

View D: Stripping costs incurred during production are a mine development cost that should be capitalized as an investment in the mine and attributed to proved reserves benefited in a systematic and rational manner.

Evaluation: It is assumed that Gold Company's effort to mine the gold varies from period to period, therefore it is expected that under a View D consensus the capitalized costs would be attributed to proved reserves benefited in a systematic and rational manner that may be similar to recognition of the Stripping Costs using a life of mine stripping ratio. Therefore, it is expected that accounting for Stripping Costs under View D would not require a significant change in the results of operations for Gold Company. However, as discussed in the Working Group Report, the classification of stripping costs within the income statement and the reporting of cash activities within the cash flow statement may be significantly impacted. Gold Company could decide that the units-of-production method of attributing the capitalized costs to the proved reserves is the systematic and rational manner to be used. In that case, the accounting under a View D consensus would result in a significant change in Gold Company's financial reporting.