ENERGY AND NATURAL RESOURCES

Impact of IFRS on the Mining Industry

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Canadian public companies are required to adopt IFRS by 2011. Don't underestimate the effort required to make this transition.

Mining companies will be affected by the Canadian Accounting Standards Board's recent decision to require Canadian public companies to adopt International Financial Reporting Standards (IFRS) for years beginning on or after January 1, 2011. Canadian Securities Administrators also have announced their intention to allow early adoption before January 1, 2011 on a case by case basis.

Key Accounting Issues for Mining Companies

Although Canadian GAAP is similar to IFRS in certain respects, many differences exist. These differences can be significant and have enterprise-wide implications.

This publication highlights some of the key accounting issues likely to arise when Canadian mining entities adopt IFRS.

Exploration and Evaluation Expenditures

IFRS 6 provides specific extractive industry guidance in respect of exploration for and evaluation of mineral resources. IFRS 6 was introduced by the IASB as a temporary standard for the extractive industries until a more comprehensive review is completed and an all encompassing accounting standard for the extractive industries is issued.

IFRS 6 permits a mining company to select an accounting policy of either immediately expensing or capitalizing exploration and evaluation (E&E) expenditures, provided the policy is applied consistently between periods and to similar items and activities. The policy to expense or capitalize should reflect the extent to which the type of E&E expenditure can be associated with finding specific mineral resources. This means that Canadian mining entities will most likely be able to retain their existing Canadian GAAP accounting policy for eligible E&E expenditures.

IFRS 6 does not cover expenditures incurred before or after the E&E phase. Entities must therefore adopt policies for pre-exploration (typically incurred before obtaining the legal rights to explore a specific area) and development activities (after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable) which are consistent with the IASB Framework.

Typical types of expenditures which may be included in the initial measurement of an E&E asset include: acquisition rights to explore (e.g., exploration licenses); topographical, geological, geochemical and geophysical studies; exploratory drilling; trenching; sampling; and activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource. E&E assets must be classified as tangible or intangible assets depending on their nature.

E&E assets are required to be assessed for impairment when facts and circumstances indicate that the carrying amount may not be recoverable. Mining entities are allowed to group exploration and evaluation assets with producing assets for the purpose of impairment testing, consistent with an established policy, subject to certain restrictions, including that the cash generating unit (CGU) or group of units cannot be larger than an operating segment

Property, Plant and Equipment (PP&E)

The mining industry is capital intensive, incurring significant expenditures on plant and equipment. IFRS requires significant components of PP&E for which different depreciation methods or rates are applicable to be depreciated separately. IFRS also requires the separate recognition and depreciation of certain non-physical components such as major overhauls and refurbishments, as well as certain major spare parts. Companies converting to IFRS will need to reassess their accounting for PP&E to determine whether further componentization of PP&E is required. Capitalization of administration and indirect overhead costs is not permitted under IFRS. In addition, IFRS provides more prescriptive guidance regarding capitalization of borrowing costs.

The first time adoption of IFRS generally requires full retrospective application of IFRS (i.e. the recreation of financial results "as if" IFRS accounting policies had always applied). The retrospective application of IFRS policies has been challenging in some countries and depends upon the state of an entity's current depreciation practices and PP&E records. IFRS 1 allows certain transitional elections relating to opening carrying values of PP&E. Working through these elections is complex and requires a practical approach.

Impairment of PP&E

IFRS has one impairment model covering PP&E, goodwill and intangible assets.

Assets are evaluated either individually or grouped in a CGU for impairment testing purposes. A CGU is the smallest group of assets that generates independent cash inflows and may be smaller than asset groups or reporting units as defined under Canadian GAAP.

The timing of impairment testing under IFRS is consistent with that testing under Canadian GAAP.

Impairment charges relating to PP&E, goodwill and intangible assets are recognized if an asset's (CGU's) carrying amount exceeds its recoverable amount (which is the greater of its value in use (an entity-specific model) or its fair value less costs to sell (market-based model)). Impairment charges relating to PP&E may be more frequent under IFRS as the cash flow test for recoverability is based on discounted cash flows (value in use), rather than being based on undiscounted cash flows.

Reversals of impairment charges, other than goodwill, are possible under IFRS as entities are required to reverse such charges if the circumstances leading to the impairment have changed.

Foreign Currency

The concept of functional currency is similar to the measurement currency concept under Canadian GAAP. However, differences in functional currencies can arise due to differences in the criteria to be considered and the priority given to certain of the criteria under IFRS. Functional currency depends on an entity's primary economic environment with particular emphasis on the currency that mainly influences sales prices and costs of labour, materials and other costs. The retroactive adoption of a different functional currency can be very complex and time consuming and will affect determinations made under other standards, such as income taxes and financial instruments. A validation of functional currency(ies) should be completed early in the IFRS conversion process.

Joint Arrangements

Joint arrangements are common in the mining industry and Canadian GAAP applies proportionate consolidation for jointly controlled entities.

While IFRS currently permits the equity method of accounting or proportionate consolidation for joint ventures, the IASB is currently reviewing responses to Exposure Draft 9, Joint Arrangements, which, in its current form, would require the equity method of accounting for many joint arrangements.

Closure and Environmental Costs

IFRS requires that decommissioning provisions be recognized when a present obligation from a past event exists and it is probable that future costs will be incurred to restore or rehabilitate a property or other long-lived asset.

The definition of a provision under IFRS is broader than Canadian GAAP. IFRS requires a liability to be recorded even when only a constructive obligation exists, which may have been created by promises or established patterns of carrying out similar activities. In addition, measurement of the liability under IFRS differs in several respects including use of a current discount rate specific to the liability and presentation of accretion of the discount as interest expense in the income statement.

Other Differences

Many other IFRS differences not unique to the mining industry can be significant sources of IFRS adjustments for mining companies and should be an integral part of the IFRS conversion plan. Some such examples include accounting for income taxes, share-based payments, financial instruments, consolidations and special purpose entities and also financial statement disclosures.

How Can KPMG Help?

KPMG has helped many organizations assess the impact and implement IFRS. We have an established conversion methodology that incorporates the different disciplines critical to a successful implementation. KPMG's IFRS conversion services teams are multidisciplinary teams comprised of professionals knowledgeable in IFRS and Canadian GAAP and skilled in both converting to, and integrating IFRS into the financial reporting processes.

Our teams are actively supported by national and internationally trained professionals with global experience in both converting to IFRS and applying IFRS. For a full description of our conversion services, refer to our publication, Managing the Transition to IFRS: The Journey to 2011, available at www.kpmg.ca/ifrs.

To learn more about our IFRS conversion services for mining companies, please contact your local KPMG office to speak with one of our IFRS professionals, some of whom are listed below:

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