



# IFRS and the mining industry

Top ten accounting issues for Canadian issuers

August 2008



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# top ten accounting issues

The transition from Canadian generally accepted accounting principles (GAAP) to International Financial Reporting Standards (IFRS) will be different for every company. However, particular industries will experience common themes and issues. This viewpoint is based on significant changes in accounting guidance, specific first-time adoption issues or the extent of data needed to be obtained and maintained for financial reporting differences. For IFRS and the mining industry, here are our views on the top ten accounting issues for Canadian issuers to consider from a financial reporting standpoint.

## 1. Impairment

The impairment guidance in IAS 36 *Impairment of Assets* applies to Property, Plant and Equipment (PP&E), goodwill and intangibles and involves significant estimation complexities for mining companies. It also applies to joint venture interests and equity accounted investments. IAS 36 sets out significantly different guidance on identifying an asset that may be impaired and the measurement of impairment.

Impairment is recognized under GAAP if an asset or group of assets' carrying amount exceeds the undiscounted cash flows expected to be generated through use of the asset. The impairment is measured as the excess of carrying value over fair value.

Impairment is recognized either on conversion to IFRS or subsequently if an asset or cash generating unit's carrying amount exceeds the higher of fair value less costs to sell or value-in-use. This differential is also the basis for measuring the extent of any impairment. As both fair value and value-in-use employ discounted cash flows, impairment may be triggered more often or earlier under IFRS. The IAS 36 model also presents other differences from GAAP in the detailed mechanics of how impairment is measured (for example, discount rate, and foreign currency cash flows). IFRS 6 *Exploration for and Evaluation of Mineral Resources* provides specific guidance on the impairment framework to be followed for assets in the exploration stage, and for assets transferred from exploration to development phases.

IAS 36 requires the subsequent reversal of impairment losses, (except for goodwill) if circumstances change and the asset or cash generating unit is no longer impaired in whole or in part. Therefore entities converting to IFRS need to consider the recognition of new impairment charges.

## 2. Mineral Resources and Property, Plant and Equipment (PP&E)

Impairment aside, there are other topical issues relating to IFRS and PP&E. IAS 16 *Property, Plant and Equipment* places more emphasis than GAAP on a "component" approach to depreciation, under which costs are allocated to "significant parts" of an asset and each part is separately depreciated. For example, large components of a mill that wear out at a separate rate from the mill as a whole would be separately depreciated. The determination of what level of components to separately account for will require some thought as IAS 16 also provides explicit guidance on the recognition of losses on the replacement of undepreciated parts of assets.

The capitalizing of start-up costs allowed by GAAP is not specifically addressed under IFRS. However, directly attributable costs incurred before an asset is ready for operation in the use intended by management can be capitalized. (Also see the discussion of borrowing costs below).

The guidance in IFRS 6 on when exploration expenditures may be, or alternatively, cannot be capitalized is set out differently from GAAP. Generally, however, practices acceptable under GAAP for these assets should be acceptable under IFRS 6.

It is presumed that historical cost determined under GAAP for mining entities is consistent with IAS 16 and can be carried forward. However, on conversion to IFRS, an entity has the option of deeming the fair value of any PP&E asset at that date as its cost. Such choices may have a significant impact on opening equity and on future earnings. Independently, after initial recognition, classes of PP&E assets may

be measured either at cost or on a revaluation model based on fair value, if the latter is reliably measurable. We do not expect many mining companies to elect a revaluation model, but expect consideration to be given to transition-date adjustments.

## 3. Provisions / Asset Retirement Obligations (including decommissioning and restoration costs)

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* uses different concepts and terminology to address the broad area of "provisions" and contains more detailed guidance than GAAP on constructive obligations and on onerous contracts. IFRS does not have a direct equivalent to CICA 3110 *Asset retirement obligations* (ARO's), but these obligations — as well as other kinds of environmental liabilities — fall within the scope of IAS 37. Differences could arise in many respects, ranging from whether or not an obligation even exists to the way an ARO liability is calculated under IFRS versus GAAP. The basis of measurement of such provisions are discounted cash outflows measured using current interest rates, in contrast to GAAP's use of initial estimates of the costs of remediation by third parties, which include a provision for profit margins. An acceptable methodology under the guidance would be to use a risk free interest rate with risks accounted for in the cash flows. If the discount rate is risk adjusted, it should not reflect risks and uncertainties already considered in the cash flow estimates. Other approaches may be acceptable.

## 4. Business Combinations, Consolidation and Special Purpose Entities

IFRS 3 *Business Combinations* was revised in early 2008. Canadian guidance on business combinations is also being revised: a converged standard is expected to be issued in Canada prior to IFRS changeover. On conversion to IFRS, an entity can choose the date from which it retroactively applies the IFRS business combination standard. This considerably simplifies conversion.

Some of the more significant differences between revised IFRS 3 and GAAP include the fair valuation of 100% of all identifiable assets and liabilities acquired once control is achieved, the transaction date as the measurement date for share consideration, the expensing of all transaction costs, and the expensing of post-acquisition changes in the fair value of certain types of contingent consideration. Post-acquisition changes in controlling interests (i.e. dilution gains/losses, step acquisitions) are treated as capital transactions. IFRS 3 also contains a new definition of a business that may capture transactions that were considered under GAAP as asset acquisitions and not business combinations.

The current IFRS guidance on special purpose entities and similar structures, SIC-12 *Consolidation – Special Purpose Entities* is fundamentally different from AcG-15 *Consolidation of variable interest entities* under GAAP. The current approach under IFRS focuses on control and the transfer of risks and rewards rather than on the *primary beneficiary* approach under GAAP. However, new harmonized guidance is expected from the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) in 2009 following increased scrutiny of off-balance sheet structures. These changes may also affect many securitization programs. Entities should closely monitor these developments, and the Accounting Standards Board (AcSB's) response in Canada.

## 5. Joint Ventures

GAAP requires that an interest in a jointly controlled entity be proportionately consolidated. IAS 31 *Interest in Joint Ventures* recommends this treatment but also currently allows equity accounting as an alternative measure. Current IASB proposals remove the proportionate consolidation alternative, except in certain limited circumstances, and introduce a requirement to equity-account all jointly controlled entities. This will have obvious pervasive results for mining entities carrying out a substantial portion of their activities

through joint ventures. Canadian GAAP may be harmonized with IFRS on this matter prior to the conversion date.

## 6. Borrowing costs

IAS 23 *Borrowing Costs*, as amended in 2007, becomes mandatorily effective in 2009. It requires that an entity capitalize borrowing costs directly attributable to acquiring, constructing or producing a qualifying asset (an asset that necessarily takes a substantial period of time to get ready for its intended use or sale) as part of the asset's cost. Mineral resources are qualifying assets for this purpose. An entity cannot choose to expense all borrowing costs as it can under GAAP.

## 7. Foreign currency

IAS 21 *The Effects of Changes in Foreign Exchange Rates* is more specific than GAAP about how an entity should determine its functional currency. This depends on identifying the entity's primary economic environment, based in particular on the currency that mainly influences sales prices for goods and services, or labour, material and other costs of providing goods or services. Further indicators of a functional currency that may also need to be considered are the currency in which the entity raises financing and the currency in which cash is maintained. If these factors point to the U.S. dollar as an entity's functional currency, it must record all transactions in U.S. dollars, and recognize Canadian denominated transactions as generating foreign currency exposures.

## 8. Financial instruments

Issuers need to carefully assess the treatment of compound financial instruments under IAS 32 *Financial Instruments: Presentation*. The measurement of the components of convertible and compound instruments could differ depending on the facts and circumstances. For example, on measuring the liability component of a compound instrument, IAS 32 emphasizes the residual nature of equity and places the primary emphasis on the liability component — GAAP does not prescribe any particular method for assigning a carrying amount to liability and equity elements contained in a single instrument. Other instruments with foreign currency implications may also be analyzed differently under IFRS compared to GAAP. For example, a conversion option not in the entity's functional currency is an embedded derivative under IAS 39. In order to establish hedge effectiveness, methods other than critical terms match must be employed: this is a significant change from GAAP.

## 9. Income taxes

Although IAS 12 *Income Taxes* and CICA 3465 *Income taxes* follow substantially the same approach (a liability method focusing on temporary differences between the tax base of an asset or liability and its carrying amount in the balance sheet), there are many detailed differences. For example, a specific provision exempts entities from recognizing temporary differences on items arising from other than business combinations that do not upon initial recognition affect profit and loss. Thus the initial recognition of provisions for ARO's are not considered as generating recognizable temporary differences. Another significant difference for some mining issuers is the recognition of temporary differences on foreign currency non-monetary assets recorded at historical cost. Under IFRS, where the realization of such an asset will give rise to tax consequences in the foreign country, the tax base of the asset is adjusted as the exchange rate changes, giving rise to a temporary difference. CICA 3465 does not recognize future tax assets or liabilities in this circumstance. An amended version of IAS 12 that may eliminate some of these differences is expected to be effective prior to 2011.

## 10. First-time adoption of IFRS

IFRS 1 *First-time Adoption of International Financial Reporting Standards* governs the first time application of IFRS. It generally requires the complete retrospective application of all current IFRS standards. However, IFRS 1 also provides a first-time adopter with a variety of options that provide some relief from retrospective application in certain specific areas that would otherwise be extremely onerous to apply on a retrospective basis. These include such matters as the elimination of cumulative translation losses and of accumulated experience gains and losses on defined benefit pension plans, as well as other options described above. There are also some mandatory exclusions from retrospective application. IFRS 1 also requires extensive disclosure including reconciliations of the effects of transitioning from GAAP to IFRS on the opening shareholders equity and on the prior year profit and loss. Given the range of issues identified here, mining issuers should anticipate considering a wide range of issues when determining their approach to IFRS 1.



# Contact us

If you would like further information, please contact:

**Glenn Ives**

North American Mining Leader  
604-640-3159  
gives@deloitte.ca

**Gregg Orr**

Vancouver Office Mining Leader  
604-640-3063  
gorr@deloitte.ca

**Susan Bennett**

Toronto Office Mining Leader  
416-601-4688  
subennett@deloitte.ca

**Terng Chen**

Toronto Office Mining Co-Leader  
416-601-6345  
tchen@deloitte.ca

**Clair Grindley**

National IFRS Specialist  
416-601-6034  
clgrindley@deloitte.ca

## IFRS publications:

You can find links to many Deloitte IFRS-related publications at [www.iasplus.com/dttpubs/pubs.htm](http://www.iasplus.com/dttpubs/pubs.htm). Here are a few examples of publications and web-based education that may be helpful to you:

**www.iasplus.com (Global IFRS website)**

Daily news updates on IASB developments as well as summaries of standards and interpretations and reference materials for download.

**www.DeloitteIFRS.ca**

Our Canadian IFRS website providing latest updates on the transition to IFRS in Canada.

**Are you Ready? Conversion from Canadian GAAP to IFRS: Planning for a cost-effective transition**

A publication addressing how Companies can most effectively and efficiently approach the conversion of Canadian GAAP to IFRS.

**The conversion of Canadian GAAP to IFRS: Volume One – scoping the effort**

A publication looking at the impact of change on the financial statements of a Canadian financial statement preparer. Emphasis is placed on those financial statement areas which are likely to be posing the biggest conversion challenge.

**IAS Plus newsletter**

A quarterly newsletter on recent developments in IFRS and accounting updates for individual countries. Plus special editions. To subscribe, visit our IAS Plus website.

**Countdown**

Deloitte Canada's IFRS newsletter providing latest updates on the transition to IFRS in Canada.

**Deloitte's IFRS e-Learning**

e-Learning IFRS training materials, modules for each IAS and IFRS and the Framework, with self-tests, available without charge at [www.iasplus.com](http://www.iasplus.com).

**Model IFRS financial statements**

Updated on an annual basis. Also a presentation and disclosure checklist.

**Comparisons of IFRS and local GAAP**

Australia, Canada, China, Denmark, Germany, New Zealand, Singapore, United States, and others.

**IFRS in your pocket**

Not just this booklet in English, but also translations into other languages.

**iGAAP 2008 Financial Instruments: IAS 32, IAS 39 and IFRS 7 explained**

This publication aims to provide a comprehensive guide to the requirements of the standards as well as represent a guide as to how the standards are being applied in practice to a wide variety of common transactions.

**First-time Adoption: A Guide to IFRS 1**

Application guidance for the "stable platform" standards expected to be effective in Canada in 2011.

**Share-based payment: A guide to IFRS 2**

Guidance on measurement of share-based payments, a benchmark study of key measurement variables, comparison with US FAS 123, and illustrative disclosures.

**Business combinations: A guide to the revised IFRS 3 and IAS 27**

Guidance on accounting for business combinations under IFRS 3(2008) and where appropriate IAS 27(2008).

**Interim financial reporting: A guide to IAS 34**

Guidance on interim financial reports and principles for recognition and measurement in interim financial statements. Includes a model interim financial report and IAS 34 compliance checklist.

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