VIEWPOINTS:
Applying IFRSs in the Mining Industry
ASSET ACQUISITION VERSUS BUSINESS COMBINATION

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Background

Mining entities often acquire projects directly or through the acquisition of shares of another mining entity.

IFRS 3, *Business Combinations*, applies to a transaction or other event in which an acquirer obtains control of one or more businesses.

If the acquired project constitutes a business, the transaction is accounted for as a business combination in accordance with IFRS 3. Amongst other things, this means that:

- identifiable assets acquired and liabilities assumed are measured at their acquisition date fair values;
- goodwill or a gain from a bargain purchase, if any, is recognized as of the acquisition date;
- acquisition-related costs (except for the costs to issue debt or equity securities) are expensed in the periods in which the costs are incurred; and
- a deferred tax asset or liability arising from the assets acquired and liabilities assumed is recognized in accordance with IAS 12, *Income Taxes*.

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Mining Industry Task Force on IFRSs

Canada's move to International Financial Reporting Standards (IFRSs) creates unique challenges for junior mining companies. Financial reporting in the sector is atypical due to significant differences in characteristics between junior mining companies and other types of companies. The Canadian Institute of Chartered Accountants (CICA) and the Prospectors & Developers Association of Canada (PDAC) created the Mining Industry Task Force on IFRSs to share views on IFRS application issues of relevance to junior mining companies. The task force views are provided in a series of papers that are available through free download. These views are of particular interest to Chief Financial Officers, Controllers and Auditors.

The views expressed in this series are non-authoritative and have not been formally endorsed by the CICA, PDAC or the organizations represented by the task force members.

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If the acquired project does not constitute a business, the transaction is accounted for as an asset acquisition. Amongst other things, this means that:

- identifiable assets acquired and liabilities assumed are measured at cost — an assigned carrying amount based on their relative fair values at the acquisition date;
- no goodwill is recognized (because an asset acquisition does not give rise to goodwill);
- acquisition-related costs are capitalized to the assets; and
- a deferred tax asset or liability arising from the assets acquired and liabilities assumed is not recognized (because of the *initial recognition exception* in IAS 12).

Whether the acquired project constitutes a business is a matter of judgment based on an assessment of the specific facts and circumstances. A Canadian mining entity may reach a different conclusion than it would have previously because of differences between IFRS 3 and pre-changeover accounting standards, EIC-124, *Definition of a Business*. For example, under pre-changeover accounting standards, there was a presumption that an entity in its development stage that has yet to commence planned principal operations did not meet the definition of a business. This presumption does not exist under IFRS 3 and in certain situations a development stage entity may meet the definition of a business under IFRS 3.

Issue

When a mining project is acquired, how does the acquirer determine whether that project meets the definition of a business under IFRS 3?[1]

Viewpoints

The determination of whether a mining project qualifies as a business under IFRS 3 is not affected by whether the project was acquired directly or through the acquisition of shares of another mining entity. IFRS 3 focuses on the acquisition of a business, not an entity.

IFRS 3 defines a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return. A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

Examples of inputs for a mining project may include mineral reserves and/or resources, employees or consultants, mining and processing equipment, mining licences, in-place contracts, and mining processing and transportation infrastructure. Examples of processes applied to those inputs may include operational processes to explore, evaluate, develop, and extract minerals. Examples of outputs may include the ultimate output such as concentrate, ore and minerals.

1 With respect to securities regulatory filings (i.e., Form 41-101F1 *Information Required in a Prospectus*), the views of securities regulators as to what constitutes a business may differ from the conclusions reached under IFRSs.

Depending on the specific facts and circumstances, consideration of the following questions may be helpful in determining whether a mining project is a business (it should be noted that no individual question is determinative in its own right):

- Does the acquired mining project have, and has the entity acquired, the two essential elements – inputs and processes applied to those inputs?
- What is the extent and significance of the acquired inputs, such as mine processing infrastructure?
- To what extent does the acquired project have resources or reserves, including support for those resources or reserves (e.g., scoping study, preliminary economic analysis, pre-feasibility report) and what is the extent and nature of the additional work to convert resources into reserves?
- To what extent are the employees working on exploration, development, or mining?
- Does the acquired project have the necessary permits (environmental or other) to allow for production?
- How close is the mining project to being a developed mine (e.g., remaining infrastructure costs are not significant)?
- Is the mining project capable of being conducted and managed as a business by a market participant (i.e., any likely theoretical buyer for the project)?
- Does the acquired project have the ability to obtain access to customers that will purchase the outputs?

This list is not exhaustive. Consideration of other questions may also be helpful.

A greenfield mining project would typically represent a collection of assets, while a mining project in the production phase[2] would typically qualify as a business under IFRS 3.

As a mining project progresses from a greenfield to a developed mine, it becomes more likely that it would qualify as a business; however, whether and when it does, in fact, qualify as a business is a matter of judgment based on an assessment of the specific facts and circumstances.

This continuum may generally be illustrated through the following diagram. However, each project should be evaluated based on its individual facts and circumstances.

2 For more information, download Background on *Different Phases of Activities* of a Mining Entity from **www.cica.ca/ifrs**

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