

## Query No. 9

**Subject:** *Estimation of Final Mine Closure Plan and treatment of the same in the books of account on year-on-year basis.*<sup>1</sup>

### A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a Government of Karnataka undertaking Company, incorporated under the Companies Act, 1956 and is having its registered office at Bangalore. Aim of the Company is primarily to explore the available mineral sources in various regions of the Karnataka State to cater to the needs of local industry and to create employment opportunities to the local community. The Company is one of the largest producers of iron ore, chromite, magnesite, limestone, dolomite, clay and granite in the state of Karnataka. The Company is engaged in scientific and eco-friendly exploration and marketing of various minerals in the state of Karnataka. The details of mine/quarry leases held by the Company are as follows:

| Particulars  | Mines     |                        | Quarries  |                     |
|--------------|-----------|------------------------|-----------|---------------------|
|              | In No's   | Lease area In Hectares | In No's   | Lease area In Acres |
| Working      | 5         | 919.56                 | 2         | 42.37               |
| Non-working  | 32        | 4856.14                | 20        | 481.62              |
| Surrendered  | 3         | 119.09                 | 16        | 161.95              |
| Cancelled    | 2         | 648.59                 | -         | -                   |
| <b>Total</b> | <b>42</b> | <b>6543.38</b>         | <b>38</b> | <b>685.94</b>       |

2. The querist has stated that as per the provisions of ‘Indian Bureau of Mines and Mineral Conservation and Development Rules (MCDR), 2017’, the holder of a mining lease shall submit a Final Mine Closure Plan (FMCP) to the competent authority for approval, two years prior to the proposed closure of the mine.

3. The querist has further stated that if the Company wants to submit the plan and make provision in the last two financial years before the closure of the lease of mines/quarries, the expected expense will be so huge that it will have huge impact on profits and will affect fair presentation as the expenditure that will be booked, pertain to several years.

4. As a prudent accounting practice, it requires that the Company shall estimate and account for the estimated cost of Final Mine Closure Plan (FMCP) and spread the same across the life of the mine/quarry for presentation of financial statements as per the applicable financial reporting framework and to give true and fair view.

5. As the Company is involved in mining activities, it needs to follow the Rules laid down by Indian Bureau of Mines. Accordingly, the management has decided to provide for the liability of FMCP and amortise it over the remaining leasehold period.

6. The querist has reproduced paragraphs 45 to 47 of Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’ as follows:

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<sup>1</sup> Opinion finalised by the Committee on 15.6.2021.

**“45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.**

46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

**47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted.”**

7. The brief description of accounting practices followed by the Company along with the facts and figures is listed below:

**a. In the year 1:** The Company estimates the Final Mine Closure Plan. This is usually done by the concerned technical department, in the year one, based on the current scheduled rate prepared by the Public Works Department, Government of Karnataka. The amount so arrived will be converted into present value using the discounting factor @7.5% and amortised over the lease period of the mine/quarry.

**b. In the year 2:**

- i. The present value of the Final Mine Closure Plan will be arrived for the year 2,
- ii. The difference between the present value of the year 2 and present value arrived for the year 1 will be treated as ‘Interest/Finance Cost’.

**c.** The detailed worksheet computed for the financial year (F.Y.) 2018-19 is furnished for a better understanding, which is briefly summarised as follows:

| <b>Particulars</b>  | <b>Amount<br/>(INR in lakhs)</b> |
|---|----------------------------------|
| Final Mine Closure Plan arrived during the year 2017-18   | 24,383.46                        |
| Present Value of Final Mine Closure Plan for the year 2017-18   | 8,627.29                         |
| Present Value of Final Mine Closure Plan for the year 2018-19   | 9,274.34                         |
| Difference of PV of FMCP of 2018-19 and 2017-18 is treated as interest charge/finance cost  | 647                              |
| Amortisation charged to Asset (Present Value of FMCP for year 2017-18 divided by life of the mines calculated for each individual mine) | 833.74                           |

**d. Scheme of journal entries in the books of account:**

**i. During the year 2017-18** **Rs. (In Lakhs)**

a) Creation of Final Mine Closure Plan as an Asset:

| <b>Particulars</b> | <b>Debit</b> | <b>Credit</b> |
|--------------------|--------------|---------------|
|--------------------|--------------|---------------|

|  |    |         |         |
|--|----|---------|---------|
| Lease Hold Land A/c                    | dr | 8627.29 |         |
| To Provision for Mine Closure Plan A/c |    |         | 8627.29 |

b) Amortisation of Final Mine Closure Plan:

| Particulars                                |    | Debit  | Credit |
|--|----|--------|--------|
| Depreciation and Amortization Expenses A/c | dr | 833.74 |        |
| To Lease hold Land A/c                     |    |        | 833.74 |

ii. During the year 2018-19

Rs. (In Lakhs)

a) Providing for difference in present values as finance cost:

| Particulars   |    | Debit | Credit |
|---|----|-------|--------|
| Finance Cost A/c  | dr | 647   |        |
| To Provision for Final Mine Closure Plan A/c  |    |       | 647    |
| (Being the difference in present value of FMCP for 2018-19 and Present value of FMCP 2017-18 accounted) |    |       |        |

b) Creation of Final Mine Closure Plan as an Asset:

| Particulars                                  |    | Debit   | Credit  |
|--|----|---------|---------|
| Lease Hold Land A/c                          | dr | 8627.29 |         |
| To Provision for Final Mine Closure Plan A/c |    |         | 8627.29 |

c) Amortisation of Final Mine Closure Plan:

| Particulars                                      |    | Debit  | Credit |
|--|----|--------|--------|
| Depreciation and Amortisation Expenses A/c       | dr | 833.74 |        |
| To Lease hold land A/c                           |    |        | 833.74 |
| (Being depreciation and amortisation of 2018-19) |    |        |        |

8. *Audit observation by the Indian Audit and Accounts department:*

- a) The Indian Audit and Accounts Department (Comptroller & Auditor General (C&AG)), which conducts the supplementary audit of the annual accounts of the Company in accordance with the provisions of the Companies Act, 2013, is not in agreement with the accounting policy followed by the Company, and they are of the view that the Final Mine Closure Plan estimated by the Company is based on the current scheduled rates and as such, the need for discounting does not arise and hence present value of Final Mine Closure Plan should be Rs. 24,383.46 Lakhs and not 8,627.29 Lakhs.
- b) The Company in its reply to the audit observation, has given assurance to the C&AG that the matter will be referred to the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) and will take the expert advice to follow the suitable accounting policies consistently.

9. The querist has separately informed that the estimate of Final Mine Closure Plan for the period 2017-18 is the expenditure to be incurred towards closure activities at the end of mine life, which is considered as per the current scheduled rate of the Public Works Department, Government of Karnataka.

## **B. Query**

10. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether the accounting practices followed by the Company is in accordance with the Generally Accepted Accounting Principles or not.
- (ii) Whether the audit observation made by the C&AG is valid or not.
- (iii) Whether there is any best practice to be followed by the Company in respect of Mine Closure obligation.

## **C. Points considered by the Committee**

11. The Committee notes that the basic issue raised by the querist relates to accounting for Mine Closure obligation by the Company under Indian Accounting Standards (Ind ASs), notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. The Committee has, therefore, restricted the opinion only to this issue and has not examined any other issue that may arise from the Facts of the Case, such as, appropriateness of the accounting for Final Mine Closure Plan expenditure under Accounting Standards notified under Companies (Accounting Standards) Rules, 2006, compliance with Mines and Mineral Conservation and Development Rules, determination/estimation/measurement of mine closure cost, accounting for leasehold land, amortisation of leasehold land, the appropriateness of the discount rate used by the Company, accounting for the mines which are closed/surrendered and provision in respect thereof, etc. The opinion, expressed hereinafter, is purely from accounting perspective and not from the perspective of interpretation of any Act/Rules, such as, Indian Bureau of Mines and Mineral Conservation and Development Rules (MCDR), 2017 etc. The Committee also presumes from the Facts of the Case that mine closure expenditure in the extant case is not of the nature of stripping costs during the production phase of the mine. Furthermore, the Committee has looked at the issue raised only from accounting principles guidance perspective and has not looked at the appropriateness of accounting/journal entries passed by the Company.

12. At the outset, the Committee notes the nature of expenditure incurred under Final Mine Closure Plan from the following definitions under 'Mineral Conservation and Development Rules, 2017':

- “(a) “abandonment of mine” means the final closure of a mine, either whole or part thereof, when the mineral deposits within the mine or part thereof have been fully extracted or when the mining operations thereon have become uneconomic;”
- “(m) “final mine closure plan” means a plan for the purpose of decommissioning, reclamation and rehabilitation of a mine or part thereof after cessation of mining and mineral processing operations, that has been prepared in the manner specified in the standard format and guidelines issued by the Indian Bureau of Mines or the Director, Atomic Minerals Directorate for Exploration and Research in respect of minerals specified in Part B of the First Schedule to the

Act where the grade of such atomic minerals is equal to or above the threshold value limits declared under Schedule-A of the Atomic Minerals Concession Rules, 2016;

- (n) “final mine closure” means steps taken for reclamation and rehabilitation of a mine or part thereof commencing from cessation of mining or processing operations in a mine or part thereof;”

The Committee notes from the Facts of the Case that the querist has stated that as per the provisions of ‘Indian Bureau of Mines and Mineral Conservation and Development Rules (MCDR), 2017’, the holder of a mining lease shall submit to the competent authority for approval, two years prior to the proposed closure of the mine, a Final Mine Closure Plan (FMCP) which means a plan for the purpose of decommissioning, reclamation and rehabilitation of a mine or part thereof after cessation of mining and mineral processing operations. Thus, there is a legal obligation for the Company in the extant case to incur decommissioning, reclamation and rehabilitation expenditure due to mining operations or extraction activities of the Company.

13. The Committee notes that Ind AS 106, ‘Exploration for and Evaluation of Mineral Resources’, states the following:

“5 An entity shall not apply this Ind AS to expenditures incurred:

- (a) before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.
- (b) after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.”

“10 Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. The *Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* issued by the Institute of Chartered Accountants of India and Ind AS 38, *Intangible Assets*, provide guidance on the recognition of assets arising from development.”

“11 In accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.”

“15 An entity shall classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired and apply the classification consistently.

16 Some exploration and evaluation assets are treated as intangible (eg drilling rights), whereas others are tangible (eg vehicles and drilling rigs). To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset. However,

using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.”

The Committee notes that Ind AS 106 provides that obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources are governed by the requirements of Ind AS 37. Further, as per the Standard, exploration and evaluation assets are treated as property, plant and equipment or intangible assets according to the nature of assets; and the expenditure related to development of resources shall also be governed by the Conceptual Framework and Ind AS 38.

The Committee now notes that Ind AS 16, ‘Property, Plant and Equipment’ contains following guidance for initial measurement of an item of property, plant and equipment:

- “16 The cost of an item of property, plant and equipment comprises:
- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
  - (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
  - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.”

Similarly, Ind AS 38, ‘Intangible Assets’ also contains the following guidance for initial measurement of a separately acquired intangible asset:

- “27 The cost of a separately acquired intangible asset comprises:
- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
  - (b) any directly attributable cost of preparing the asset for its intended use.”

The Committee notes from the above that both Ind AS 16 and Ind AS 38 require costs that are directly attributable to acquire the asset or to bring the asset to the location and condition necessary for it to be capable of operating in the intended manner to be included in the initial measurement. Further, Ind AS 16 specifically provides that the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period (for purposes other than to produce inventories during that period) shall be included in the cost of an item of property, plant and equipment.

14. The Committee further notes the requirements of Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’ as follows:

- “14 A *provision* shall be recognised when:

- (a) **an entity has a present obligation (legal or constructive) as a result of a past event;**
- (b) **it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and**
- (c) **a reliable estimate can be made of the amount of the obligation.**

**If these conditions are not met, no provision shall be recognised.”**

“19 It is only those obligations arising from past events existing independently of an entity’s future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. *Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused.* In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.” (Emphasis supplied by the Committee.)

**“36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.**

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.”

**“42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.**

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is

needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

- 44 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

#### **Present value**

- 45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.**

- 46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

- 47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted."**

- “60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost.”

In this regard, Committee also notes following paragraphs of Guidance Note on Accounting for Oil and Gas Producing Activities (for entities to whom Ind AS is applicable) although the Guidance Note may not be strictly applicable for mineral resources other than oil and gas:

#### **“Accounting for Abandonment Costs**

33. Abandonment costs are the costs incurred on discontinuation of all operations and surrendering the property back to the owner. These costs relate to plugging and abandoning of wells; dismantling of wellheads; production; and transport facilities and to restoration of producing areas in accordance with license requirements and the relevant legislation.

34. In accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources. Thus, an entity should capitalise as part of property, plant and equipment or intangible asset, as the case may be, the amount of provision required to be created for subsequent abandonment. *The provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, industry practice, etc. Where the effect of the time value of money is material, the amount of the provision should be the present value of the expenditures expected to be required to settle the obligation. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect current market assessments of the time value of money and the risks*

*specific to the liability. The discount rate should not reflect risks for which future cash flow estimates have been adjusted. ... However, the change in the estimated provision due to the periodic unwinding of the discount should be recognized in statement of profit and loss as it occurs. Since abandonment costs do not reflect borrowed funds, the unwinding cost would not be a borrowing cost eligible for capitalization.”*

(Emphasis supplied by the Committee.)

15. As discussed in paragraph 12 above, the Committee notes that the Company is under a legal obligation to incur costs on site restoration and mine closure work as per its governing laws. Under Ind AS 37, a provision is required to be recognised in respect of such costs since there exists an obligation to perform the site restoration and closure of the mine. However, the relevant regulations should be taken into account when determining the existence and extent of the obligation. Thus, the Company in the extant case should recognise a decommissioning or restoration provision in respect of the mine closure obligation and this obligation may arise even before any production takes place. The Committee further notes that the accounting for decommissioning provision will depend on how the related costs have been accounted for. If the related costs are capitalised, the associated decommissioning costs should also be capitalised and included in the initial measurement of the related tangible or intangible asset. However, if the related costs are expensed (such as certain exploration and evaluation costs that do not meet the capitalisation criteria under Ind AS 106), any associated decommissioning or restoration costs should also be expensed.

16. With regard to measurement of the provision, the Standard provides that the provision shall be recognised at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period. Thus, the Committee is of the view that the provision for estimated expenditure should be made at current prices at the reporting date considering the relevant conditions and obligation. Further, since the mine closure costs are towards the closure activities at the end of the mine life, the obligation is a long-term obligation and therefore, if the effect of time value of money is material, the provision should be discounted. Accordingly, the initial cost of the related asset should include the present value of the expenditure expected to be required to settle the obligation. Thus, although the estimates are made at current prices on the reporting date, since the estimates are for the expenditure to be incurred in the future at the end of mine life, these are discounted if the effect of time value of money is material.

Subsequently, where discounting is used, the carrying amount of a provision is increased in each period to reflect the passage of time. This increase is recognised as borrowing cost. Further, the cost of the related asset, including the initial estimate of mine closure costs, should be depreciated/amortised based on the pattern in which the related asset's future economic benefits are expected to be consumed in accordance with the requirements of the relevant Standards.

#### **D. Opinion**

17. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 10 above:

(i), (ii) & (iii) The Company should follow the accounting for mine closure obligation, as detailed in paragraphs 13 to 16 above. The appropriateness of the accounting practices followed by the Company in accordance with the generally accepted accounting principles and validity of C&AG observations would depend on the above-mentioned accounting.

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