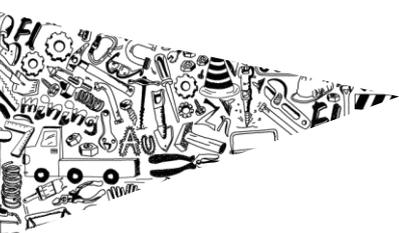


IFRS 15 - the new revenue recognition standard

Impact on mining and metals entities

September 2014



What you need to know

- ▶ Application of the new revenue recognition standard will require entities to use a greater degree of judgement.
- ▶ The key issues for the sector include:
 - ▶ Evaluating whether a contract is within the scope of the new standard
 - ▶ Determining when control transfers
 - ▶ Accounting for fixed and provisionally priced commodity sales contracts
 - ▶ Assessing the impact on take-or-pay and other long-term arrangements.
- ▶ Mining and metals entities may have to change their processes and information systems to capture information they need to apply the standard and make the required disclosures.
- ▶ The standard is applicable for annual reporting periods commencing on or after 1 January 2017, with early adoption permitted.

Overview

Mining and metals entities may need to change certain revenue recognition practices as a result of IFRS 15 *Revenue from Contracts with Customers*, the new revenue recognition standard that was jointly issued by the International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (the FASB) (collectively, the Boards). IFRS 15 supersedes virtually all revenue recognition requirements in IFRS and US GAAP.

IFRS 15 provides accounting requirements for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other IFRS requirements, such as IAS 17 *Leases*). The standard also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant and equipment (PP&E).



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Our *Applying IFRS, A closer look at the new revenue recognition standard* (June 2014)¹, provides an in-depth discussion of IFRS 15. This publication summarises the key implications of the standard for mining and metals entities.

Mining and metals entities also may want to monitor the discussions of the Boards' Joint Transition Resource Group for Revenue Recognition (TRG). The TRG was created to help the Boards determine whether more implementation guidance is needed. The TRG will not make formal recommendations to the Boards or issue guidance. Any views discussed by the TRG will be non-authoritative.

The views we express in this publication are preliminary; we may identify additional issues as we analyse the standard and entities begin to interpret it, and our views may evolve during that process.

Key sector considerations

To apply IFRS 15, mining and metals entities will need to change the way they evaluate many of their transactions, even if the amounts they report will not change significantly, if at all. While, in general, we do not expect IFRS 15 will significantly affect the revenue recognition profiles and practices for many common types of arrangements in the mining and metals sector, entities will still need to carefully evaluate how it may affect specific contracts and their financial reporting processes overall.

Mining and metals entities will need to use significant judgement as they evaluate whether contracts fall within the scope of IFRS 15, determine when control passes to a customer, account for fixed-price and provisionally-priced commodity sales contracts and account for complex take-or-pay and similar arrangements.

Identifying when to apply IFRS 15

Mining and metals entities must first evaluate whether their contracts are subject to IFRS 15, or if they are within the scope of other IFRSs, such as the leasing or financial instruments standards. This assessment could change in the future as a result of the Boards' joint project on leases.

As mining arrangements are becoming increasingly complex, it may be challenging to determine whether the counterparties are collaborators or customers. Production sharing contracts, concession agreements and similar contracts could be considered collaborative arrangements and, hence, outside the scope of the standard. However, mining and metals entities may provide such counterparties other goods and services that are within of the scope of IFRS 15.

The standard provides application guidance for contracts with repurchase agreements to assist entities in determining whether the arrangement is a sale, a financing arrangement or a lease (within the scope of IAS 17). This could affect some tolling agreements with smelters or refiners, which may include these provisions. To account for these arrangements appropriately, entities must carefully evaluate the repurchase requirements and the relationship between the original selling price and the repurchase price (considering the time value of money).

Mining and metals entities may dispose of non-financial assets, such as PP&E. IFRS 15 consequentially amends other standards, such as IAS 16 *Property, Plant and Equipment*, and effectively establishes a new model for derecognising non-financial assets that applies the concepts in IFRS 15, even for sales to non-customers. As a result, the calculation, and timing of recognition, of gains/losses on sales of these assets may differ from that under current IFRS.

It may be challenging to determine whether the counterparties to mining contracts are collaborators or customers.

¹ Available on www.ey.com/ifrs

Determining when control transfers

The standard requires entities to recognise revenue when (or as) control transfers to the customer. The standard provides its own definition and indicators of control. For gold bullion sales, for example, the change in custody, and hence determination of control, can be complex. This is because such arrangements involve shipment to a third party refinery for processing before ultimate physical delivery to the customer. Mining and metals entities will need to evaluate when control transfers, and therefore when to recognise revenue to ensure these assessments align with the control concepts in the standard.

IFRS 15 also provides application guidance on bill-and-hold arrangements that is more detailed than current IFRS. We expect that bill-and-hold transactions that qualify for revenue recognition under current IFRS will also qualify for revenue recognition under IFRS 15. However, contracts that do not currently qualify may do so under IFRS 15. Therefore, entities may be able to recognise revenue earlier than they do today, for example, in contracts with delayed shipping terms to mitigate customer storage constraints. Entities with bill-and-hold arrangements may also have a separate performance obligation to provide custodial services over the holding period.

Fixed and provisionally priced arrangements

Mining and metals entities may find it challenging to estimate the transaction price, particularly when it includes variable consideration. Sales contracts for certain commodities (e.g., copper) often include provisional pricing at the time of shipment, with final pricing based on the average market price for a particular period. Entities will need to continue to evaluate whether these terms represent embedded derivatives that they must account for separately, as they do under current IFRS.

Even fixed-price contracts may require entities to pay attention to market pricing, especially for actively traded commodities. For contracts for the delivery of commodities over multiple periods, it is unclear whether they must determine the stand-alone selling price using the forward price curve or if they can use another amount, such as the spot price.

Evaluating take-or-pay and similar long-term supply arrangements

Entities that enter into multi-period contracts with terms calling for price escalations or declines in different periods (e.g., some take-or-pay contracts, minimum capacity contracts, long-term supply contracts) will need to properly identify the performance obligations and evaluate the reasons for the price changes. An entity's conclusions will determine whether it will allocate and recognise revenue based on stand-alone selling prices, follow contractual pricing or use a straight-line or other pattern. These contracts also may contain a significant financing component that an entity will have to account for separately.

Next steps

Mining and metals entities will need to evaluate the requirements of IFRS 15 and make sure they have processes and systems in place to collect the necessary information to implement the standard. This is the case even if their accounting results will not change significantly, or at all. They may also want to monitor the ongoing discussions of the Boards and TRG to consider the impact of evolving interpretations and application of the new standard to common transactions. Entities also should consider their communication plans with investors and other stakeholders, including their plan for disclosures about the effects of new accounting standards that are issued but not yet effective, as required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Take-or-pay contracts and other similar contracts often contain complex terms that will require careful analysis for each step of the model.

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EY's Global Mining & Metals Center

With a volatile outlook for mining and metals, the global mining & metals sector is focused on cost optimization and productivity improvement, while poised for value-based growth opportunities as they arise. The sector also faces the increased challenges of changing expectations in the maintenance of its social license to operate, skills shortages, effectively executing capital projects and meeting government revenue expectations.

EY's Global Mining & Metals Center brings together a worldwide team of professionals to help you succeed – a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector. The Center is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow. Ultimately it enables us to help you meet your goals and compete more effectively.

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