The new revenue recognition standard - mining & metals

June 2015
What you need to know

• IFRS 15 creates a single source of revenue requirements for all entities in all industries. Consistent with current IFRS, it is principles-based, but it will require entities to use a greater degree of judgement.

• To apply IFRS 15, mining and metals entities will need to change how 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 to 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 may find it challenging to assess the impact of IFRS 15, in particular, when evaluating whether a contract is in scope, determining when control transfers to a customer, accounting for fixed and provisionally-priced commodity sales contracts, and assessing the impact on take-or-pay and other similar long-term contracts.
Overview

IFRS 15 Revenue from Contracts with Customers (the standard) is the new revenue standard issued by the International Accounting Standards Board (IASB) and jointly developed with the US Financial Accounting Standards Board (FASB) (collectively, the Boards). Mining and metals entities will need to change how they evaluate many of their transactions, even if the amount of revenue they report may not change significantly, or at all. While in general, we do not expect IFRS 15 to significantly affect the accounting for many common types of arrangements in the sector, entities will still need to carefully evaluate how IFRS 15 may affect specific contracts and their financial reporting processes overall.

Mining and metals entities will need to carefully analyse their contracts to determine: whether they are in the scope of IFRS 15; when control passes to a customer (e.g., for sales of gold bullion or the impact of shipping terms); and how they will account for fixed-price and provisionally-priced commodity sales contracts. For other arrangements, such as take-or-pay contracts and other similar long-term arrangements, a thorough analysis of the standard will be required to determine the potential impact. Changes may also be required to processes and information systems to capture information needed to apply the standard and make the required disclosures.

IFRS 15 and the FASB’s new revenue standard, which are substantially consistent, will supersede virtually all revenue recognition standards in IFRS and US GAAP, respectively.

IFRS 15 specifies the accounting treatment for revenue arising from contracts with customers. It 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 recognition and measurement of gains and losses on the sale of certain non-financial assets, such as property, plant and equipment and intangible assets.

This publication considers key implications of IFRS 15 for mining and metals entities. This publication expands on our earlier IFRS Developments, IFRS 15 – the new revenue recognition standard: impact on mining and metals entities (September 2014). It also provides an overview of the model in IFRS 15. This publication supplements our Applying IFRS. A closer look at the new revenue recognition standard (J une 2014)¹ (general publication) and should be read in conjunction with that publication.

To support stakeholders with the implementation of the standard, the Boards have established the Joint Transition Resource Group for Revenue Recognition (TRG).² The TRG was created to help the Boards determine whether additional interpretation, application guidance or education is needed on implementation issues and other matters submitted by stakeholders. The TRG will not make formal recommendations to the Boards or issue guidance. Any views produced by the TRG are non-authoritative.

¹ Available on www.ey.com/ifrs
² IFRS Developments and Applying IFRS covering the discussions of the TRG are available on http://www.ey.com/ifrs
1. Summary of the new standard

IFRS 15 specifies the requirements an entity must apply to recognise and measure revenue. The core principle of the standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The principles in IFRS 15 are applied using the following five steps:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations
5. Recognise revenue when (or as) the entity satisfies each performance obligation

An entity will need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. An entity will also have to apply the requirements of IFRS 15 consistently to contracts with similar characteristics and in similar circumstances.

On both an interim and annual basis, an entity will need to disclose more information than it does under current IFRS. Annual disclosures will include qualitative and quantitative information about the entity’s contracts with customers, significant judgements made (and changes in those judgements) and contract cost assets.

2. Effective date and transition

IFRS 15 is effective for annual periods beginning on or after 1 January 2017. Early adoption is permitted for IFRS preparers, provided that fact is disclosed, and for first-time adopters of IFRS.

All entities will be required to apply the standard retrospectively, either using a full retrospective or a modified retrospective approach. The Boards provided certain practical expedients to make it easier for entities to use a full retrospective approach.

Under the modified retrospective approach, financial statements will be prepared for the year of adoption using IFRS 15, but prior periods will not be adjusted. Instead, an entity will recognise a cumulative catch-up adjustment to the opening retained earnings (or other appropriate component of equity) at the date of initial application for contracts that still require performance by the entity (i.e., contracts that are not completed). In addition, an entity will disclose all line items in the year of adoption as if they were prepared under current IFRS (i.e., IAS 18 Revenue, IAS 11 Construction Contracts and related Interpretations).

For more information about the effective date and transition options, see Section 1 of our general publication.3

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3 At their March 2015 joint meeting, the Boards tentatively decided to provide additional transition relief under both IFRS and US GAAP. Our IFRS Developments summarising these discussions is available on www.ey.com/ifrs
3. **Scope**

IFRS 15 applies to all contracts with customers to provide goods or services as part of its ordinary activities, except for the following contracts, which are specifically excluded from the scope:

- Lease contracts within the scope of IAS 17
- Insurance contracts within the scope of IFRS 4 Insurance Contracts
- Financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

3.1 **Inventory exchanges with the same counterparty**

Entities in the mining and metals sector may exchange inventory with other entities in the same line of business, which is often referred to as ‘loans/borrows’. This can occur with commodities such as uranium, coal or certain concentrates, for which suppliers exchange or swap inventories in various locations to supplement current production, to facilitate more efficient management of capacity and/or to help achieve lower transportation costs.

What’s changing from current IFRS?

While both IAS 18 and IFRS 15 scope out certain non-monetary exchanges, the specific wording used in the two standards differs. IAS 18 uses the words “similar in nature and value”, whereas IFRS 15 uses the words “exchanges between entities in the same line of business to facilitate sales to customers or potential customers”. While we understand the Boards did not expect or intend the treatment of inventory exchanges to change as a result of IFRS 15, the differences in wording create some uncertainty as to whether this requirement can be interpreted and applied in the same way as current IFRS. In particular, whether some transactions that are currently treated as exchanges of dissimilar goods (and, hence, revenue generating) may not now be considered to be revenue-generating if the entities are in the same line of business and the exchange is intended to facilitate sales to customers or potential customers.

Also, while the scoping section of IFRS 15 makes it clear that such inventory exchanges do not result in revenue generation, it does not provide application guidance on how the transactions between the two parties would be accounted for and no other specific requirements exists within IFRS. Given the lack of clarity, the current divergence in accounting may continue.

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4 IAS 18.12
5 IFRS 15.5(d)
3.2 Challenges in identifying the customer

The standard defines a customer as “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration”\(^6\). Determining who the customer is and, therefore, which contracts are in scope, will require an assessment of the individual facts and circumstances. The absence of specific application guidance on the types of activities that are considered an entity’s ordinary activities and, therefore, who may be customers of an entity may lead to diverse interpretations.

There are many complex contracts in the mining and metals sector and there is some diversity in the accounting for these contracts. While, in many transactions, the customer is easily identifiable, in others, it may be less clear which counterparties are customers of the entity. This may be particularly relevant when assessing production sharing contracts or royalty arrangements, which we discuss below. Further discussion is also available in section 2.1 of our general publication.

3.2.1 Production sharing contracts/arrangements (PSCs)

While PSCs are more commonly found in the oil and gas sector, similar arrangements also exist in the mining and metals sector and may be referred to as PSCs or Contracts of Work (CoWs) (for simplicity, in this publication, they will collectively be referred to as PSCs).

A PSC is a contract between some form of national government entity of a host country and the contracting enterprise (the mining company) to carry out minerals exploration, development and production activities, or any combination of the three, in accordance with the specified terms of the contract. The mining company generally will be responsible for extracting the government entity’s share of production from the mine and is typically responsible for 100% of exploration costs and some or all of development and production costs.

What’s changing from current IFRS?

Currently, there are no specific requirements within IFRS governing the accounting for PSCs, which has resulted in accounting approaches that have evolved over time. These contracts are generally considered to be more akin to working interest relationships than pure services contracts. This is because the mining company assumes risks associated with performing mining activities and receives a share (and often a greater share) of future production as specified in the contract. Under current IFRS, when an entity determines it has an interest in the mineral rights themselves, revenue is recognised only when the mining company receives its share of the extracted minerals under the PSC and sells those volumes to third party customers. In other arrangements, the entity’s share of production is considered a fee for services which is recognised as the services are rendered to the national government entity.

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\(^6\) IFRS 15 Appendix A
IFRS 15 notes that, in certain transactions, while there may be payments between parties in return for what appears to be goods or services of the entity, a counterparty may not always be a ‘customer’ of the entity. Instead, the counterparty may be a collaborator or partner that shares the results from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity’s ordinary activities. Generally, contracts with collaborators or partners are not within the scope of the standard, except as discussed below.

The Boards decided not to provide additional application guidance for determining whether certain revenue generating collaborative arrangements will be in the scope of the standard. In the Basis for Conclusions, the Boards explain that it would not be possible to provide application guidance that applies to all collaborative arrangements. Therefore, the parties to such arrangements need to consider all facts and circumstances, such as the purpose of the activities undertaken by the counterparty, to determine whether a vendor-customer relationship exists that is subject to the standard.

In determining whether the contract between the government entity and the mining company is within the scope of the standard, an entity must look to the definition of a customer and what constitutes ‘ordinary activities’. It may be that certain parts of the PSC relationship involve the mining entity and the national government entity acting as collaborators (and, hence, that part of the arrangement would be outside the scope of IFRS 15), while the two parties may act as supplier and customer for other parts of the arrangement. If the latter occurs, then that part of the contractual arrangement will be within the scope of IFRS 15 and an analysis of the impact of the requirements will be necessary.

How we see it

As the Boards appear to be relying on the current definition of ‘revenue’ and what constitutes ‘ordinary activities’, it is unclear whether IFRS 15 will lead to any significant changes in the accounting for PSCs. The relationship between the mining entity and the government entity will not often represent a supplier-customer relationship in respect of the provision of services. Instead, it may be considered a contract between collaborators or partners, which would be outside the scope of IFRS 15.

Having said this, the terms and conditions of contracts with governments continue to evolve and while certain aspects may represent a collaborative arrangement, others may represent a supplier-customer arrangement. As such, the facts and circumstances of all arrangements need to be carefully assessed to determine the nature of the relationship between the two parties.

An entity will also need to analyse the impact of such an assessment on its ability to recognise reserves.

7 IFRS 15.BC54
3.3 Royalty income
Entities in the mining and metals sector sometimes sell part of their interests in a mine or area, or a particular stream of resource (e.g., the owner of a copper/gold resource may sell off access to the mineral sands resource). The transaction may involve an upfront payment and/or a requirement for the acquiring entity to pay the vendor a royalty amount over a certain period of time (e.g., based upon a fixed dollar amount per volume of product extracted from the area). Alternatively, the acquiring entity may pay a net profit interest, that is, a percentage of the net profit (calculated using an agreed formula) generated by the interest sold. There may be other types of arrangements where the mining and metals entity grants another entity a right in return for a royalty payment.

What's changing from current IFRS?
Under current IFRS, accounting for mineral rights and mineral reserves is scoped out of a number of standards including IAS 18, IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets. Consequently, diverse practice has emerged in the accounting for such transactions.

With respect to the future royalty amounts, these can take a number of different forms.
Future receipt is solely dependent on production: For some arrangements, the future royalty stream is solely dependent on future production, such that, if there is no future production, no royalty income will be received.

We observe that, in some instances, such royalty receivable amounts are only recognised once the production has actually occurred and the royalty is then due and not when the interest in the mine is originally sold. Therefore, the associated inflows (i.e., the royalty income) are often only recognised when the related mineral is extracted. Such royalty receipts are then often disclosed as either revenue or other income.

An alternate approach observed is that the sale of the mining interest is considered to create a contractual right to receive these royalty amounts (i.e., a contractual right to receive cash). Therefore, such royalty amounts (and, hence, the related receivable) would be recognised at fair value at the date of disposal and included in the calculation of the gain or loss on sale. Further divergence then exists as to how subsequent movements in the receivable are recognised in profit or loss (i.e., as revenue or as other gains/losses).

Minimum additional amount due, but timing linked to production: In other arrangements, the entity may be entitled to receive a certain additional (minimum) amount of cash regardless of the level of production, but the timing of receipt is linked to future production. This type of arrangement is considered to establish a contractual right to receive cash at the point when the disposal transaction occurs. Therefore, an entity recognises a receivable and the associated income when the arrangement is entered into, and this will form part of the gain or loss on sale of the mineral interest.

Under IFRS 15, the impact will depend on whether the royalty arrangement is considered to arise from a collaborative arrangement; in the context of a supplier-customer relationship; or from the sale of a non-financial asset.
(a) Royalty arrangements with collaborative partners
IFRS 15 only addresses contracts with customers for goods or services provided in the ordinary course of an entity’s business. As discussed in section 3.2.1 above, IFRS 15 does not apply to arrangements between collaborative partners, that is, between entities that share in the risks and benefits of developing an asset or project. So where royalties are received by an entity as part of such an arrangement, they will generally not be in the scope of the standard, unless the collaborator or partner meets the definition of a customer for some, or all, aspects of the arrangement.

(b) Royalty arrangements with customers
Unlike current IFRS, IFRS 15 does not scope out revenue from the extraction of minerals. Therefore, regardless of the type of product being sold, if the counterparty to the contract is determined to be a customer, then the contract will be in scope of IFRS 15.

If a royalty arrangement is considered to be a supplier-customer relationship (and, hence, is in scope), mining and metals entities may face a number of challenges in applying the standard. These may include identifying the performance obligations, determining the transaction price (e.g., if consideration is variable and dependent upon actions by the customer, which would be the case for the future extraction of minerals), applying the constraint on variable consideration, and reallocating the transaction price when and if there is a change in the transaction price.

When considering the accounting for such royalties, IFRS 15 contains specific requirements that apply to licences of intellectual property, which may appear similar to some types of royalty arrangements in the mining and metals sector. However, it is important to note that these requirements only apply to licences of intellectual property and not all sales-based or usage-based royalties. So, the general requirements applicable to variable consideration, including those relating to the constraint, will need to be considered (refer to sections 6.1 and 6.2 below for further discussion).

(c) Royalty arrangements and the sale of non-financial items
If the royalty arrangement is not considered to relate to a contract with a customer nor to a collaborative arrangement, but instead, relates to the sale of a non-financial asset (e.g., an interest in a mine), IFRS 15 may still require some changes. This is because the existing requirements for the recognition and measurement of a gain or loss on the transfer of some non-financial assets that are not the output of an entity’s ordinary operations (e.g., property, plant and equipment in the scope of IAS 16), have been amended to now refer to the requirements of IFRS 15.

Specifically, these changes require an entity to:

- Determine the date of disposal and, therefore, the date of derecognition:
  Entities will make this evaluation based on when the recipient obtains control of the asset. The criteria for assessing when control has passed are set out in IFRS 15 in relation to the satisfaction of performance obligations as opposed to the risk and rewards assessment currently in IAS 18.
Measure the consideration to be included in the calculation of the gain or loss arising from disposal:

Entities will use the requirements of IFRS 15 for determining the transaction price, including requirements related to variable consideration. These specify that such amounts can only be included in the transaction price to the extent that it is highly probable that a significant reversal in the amount of a gain recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. That is, the provisions relating to the constraint on variable consideration will apply (refer to Section 5.1.3 of our general publication for further information on the requirements relating to the constraint of revenue).

Recognise any subsequent changes to the estimated amount of consideration:

Any subsequent movements are recognised as a gain or loss in profit or loss in the period that the change occurs or the variable consideration meets the requirements of the constraint.

Mineral rights and mineral reserves (and, hence, the associated capitalised costs) are outside the scope of both IAS 16 and IAS 38. However, in selecting an accounting policy for the disposal of these assets, in practice, most entities look to the principles of these two standards. Therefore, these requirements are likely to be applied by analogy to arrangements in which an entity sells all (or part) of its mining properties and some of the consideration comprises a royalty-based component.

There is also a lack of clarity as to how to apply the requirements of IFRS 15 to such arrangements where, by virtue of the royalty rights, the vendor is considered to have retained an interest in the mineral property. This may impact what is recognised or derecognised from the balance sheet in terms of mineral assets and/or financial assets, and also the gain/loss that is recognised in profit or loss.

IFRS 15 and an analysis of the impact of the requirements will be necessary.

How we see it

Currently, IAS 18 specifically applies to royalty income, but scopes out revenue from the extraction of mineral ores. While IFRS 15 does not separately address royalties (except for sales and usage-based royalties relating to intellectual property) and no longer scopes out revenue from the extraction of mineral ore, if such payments arise as a result of a contract with a customer, they will be in the scope of this standard. It may not always be clear whether a counterparty is a customer, so judgement will be required.

Likewise, royalty arrangements included as part of the sale of a non-financial asset will be impacted by the new requirements of IFRS 15 through the consequential amendments to IAS 16 and IAS 38. Given that most royalty arrangements in these situations tend to be variable in nature, applying the requirements of the standard may have significant practical implications on the accounting for such arrangements.
3.4 Interactions with other standards
The standard states that if a contract is partially within the scope of IFRS 15 and partially within the scope of another standard, (e.g., IAS 17, IFRIC 4 Determining whether an Arrangement contains a Lease or IAS 39), entities will first apply the separation and measurement requirements of the other standard, if available (e.g., accounting for an embedded lease or an embedded derivative). Once the contract elements are separated, IFRS 15 will be applied only to the revenue elements. If however, the other standards do not specify how to separate and/or initially measure one or more parts of the contract, then the entity will apply IFRS 15 to separate and/or initially measure the part (or parts) of the contract.

3.4.1 Provisionally priced contracts
Sales contracts for certain commodities (e.g., copper) often include provisional pricing at the time of shipment of the metal concentrate, for which final pricing is based on a future price. The final sales price may be based on the average market price for a particular future period (the quotational period or QP) or the price on a fixed date after delivery. This type of arrangement is common when an entity produces a mineral concentrate that is sold to a smelter or refiner that produces the fully refined metal that is then sold into the market.

Under current IFRS, if these price adjustment features meet the definition of an embedded derivative, they are separated from the contract and accounted for under IAS 39 starting at the date of delivery. Revenue is then initially recognised at the estimated fair value of the total consideration received or receivable when the mineral concentrate is delivered, which is usually when it passes the ship's rail. This fair value is estimated by reference to forward market prices.

Any changes in the fair value of the embedded derivative from the date of delivery to the end of the QP are recognised in profit or loss for the period. IAS 39 does not specify the presentation of such subsequent fair value movements. Consequently, this has led to some divergent practices for presenting fair value gains or losses in profit or loss. The majority of sector participants present these movements as part of revenue, while others present them as part of derivative/other gains and losses.

What's changing from current IFRS?
While IFRS 15 will not change the assessment of the existence of embedded derivatives, as noted above in section 3.4, IFRS 15 states that if a contract is partially within scope of this standard and partially in the scope of another standard, entities will first apply the separation and measurement requirements of the other standard(s). Therefore, to the extent that the provisional pricing features are considered embedded derivatives that require separation from their host contract, they will continue to be outside the scope of IFRS 15 and entities will still be required to account for these in accordance with IAS 39.8

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8 We have not specifically considered the requirements of IFRS 9 in this publication. However, it is worth noting that under IFRS 9, the embedded derivative will not be separated from the financial asset (being the receivable), but instead, the entire instrument will be accounted for under IFRS 9 either at amortised cost (if the relevant conditions are met) or fair value.
Revenue in respect of the host contract will be recognised when control passes to the customer and will be measured at the amount to which the entity expects to be entitled - being the estimate of the price expected to be received at the end of the QP. Throughout the QP, any movements in the embedded derivative, which has been separated from the host contract, will be recognised in profit or loss. So, provided an entity determines that control is considered to pass to the customer at the same point\(^9\) (i.e., the point of delivery), effectively, there will be no change from current IFRS.

However, IFRS 15 does not address the presentation of the subsequent movements in the embedded derivative in profit or loss. It is our understanding that the Boards, in issuing the new standards, only addressed a subset of total revenue (i.e., revenue from contracts with customers), but did not provide further clarification as to what constitutes total revenue.

While IFRS 15 does not specifically prohibit such movements in the value of an embedded derivative from being described as revenue, it does contain specific disclosure requirements for revenue from contracts with customers. Specifically, it requires an entity to disclose “revenue recognised from contracts with customers, which the entity shall disclose separately from its other sources of revenue”\(^10\) either in the statement of comprehensive income or in the notes. Therefore, entities that recognise such embedded derivative movements as part of revenue and do not separately track them will now need to do so, in order to be able to disclose these amounts separately from revenue from contracts with customers. For some, this may require changes to systems and processes.

**How we see it**

Provisional pricing features that are considered embedded derivatives that require separation under IAS 39 will be outside the scope of IFRS 15, in line with current practice.

While it is clear that the movements in these embedded derivatives cannot be described as revenue from contracts with customers, there have been no other specific changes which would prohibit these amounts from being presented as part of another revenue caption.

Given this, the common current practice of presenting movements in the fair value of embedded derivatives as part of total revenue is likely to continue. However, the specific disclosure requirements of IFRS 15 require entities to track and present revenue from contracts with customers separately (either on the face of the income statement or in the notes to the financial statements) from other sources of revenue.

4. **Identify the contract with the customer**

The model in IFRS 15 applies to each contract with a customer. Any contracts that create enforceable rights and obligations fall within the scope of the standard. Contracts may be written, oral or implied by an entity’s customary business practices, but must be enforceable and meet specified criteria. An entity is required to combine two or more contracts that it enters into at, or near, the same time with the same customer and account for them as a single contract, if they meet specified criteria.

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\(^9\) Refer Section 8.1 for further discussion about the transfer of control

\(^10\) IFRS 15.113
An assessment of collectability is included as one of the criteria for determining whether a contract with a customer exists. That is, an entity must conclude that it is probable that it will collect the consideration to which it expects to be entitled. The amount of consideration to which an entity expects to be entitled (i.e., the transaction price) may differ from the stated contract price (e.g., if an entity intends to offer a concession and accept an amount less than the contractual amount). When performing the collectability assessment, an entity only considers the customer’s ability and intention to pay the expected consideration when due. \(^{11}\)

This step of the model also includes requirements on accounting for contract modifications. A contract modification is a change in the scope or price (or both) of a contract. An entity must determine whether the modification should be accounted for as a separate contract or as part of the original contract. Specific criteria must be met for a modification to be considered a separate contract, and relate to whether the modification results in the addition of distinct goods or services, and whether they are priced at their stand-alone selling prices (see Section 7 below).

A contract modification that does not meet the criteria to be accounted for as a separate contract is considered a change to the original contract. It is treated as either the termination of the original contract and the creation of a new contract or as a continuation of the original contract, depending on whether the remaining goods or services to be provided after the contract modification are distinct.

We discuss contract modifications in more detail in Section 3.3 of our general publication.

4.1 Take-or-pay arrangements
A take-or-pay arrangement is a supply agreement between a customer and a supplier in which the pricing terms are set for a specified minimum quantity of a particular good or service. The customer must pay the minimum amount as per the contract, even if it does not take the volumes. There also may be options for additional volumes in excess of the minimum.

Mining and metals entities will need to apply judgement when identifying the contract for take-or-pay arrangements. The initial contract for accounting purposes may be for the minimum amount specified because this may represent the only enforceable part of the arrangement. Any option for additional goods or services will need to be evaluated to determine if those goods or services should be considered a separate contract or if the option represents a material right in the original contract (because the price of the additional goods or services is at a significant discount from the stand-alone selling price of those goods or services). Refer Section 5.2 below for further discussion on options for additional goods.

We discuss take-or-pay arrangements in more detail in Section 9 below.

\(^{11}\) At their March 2015 joint meeting, the Boards discussed issues related to collectability that had been raised by constituents and discussed at the January 2015 TRG meeting. Our IFRS Developments and Applying IFRS summarising these discussions are available on http://www.ey.com/ifrs
5. Identify the performance obligations in the contract

Once an entity has identified the contract with a customer, it evaluates the contractual terms and its customary business practices to identify all the promised goods or services within the contract and determine which of those promised goods or services (or bundles of promised goods or services) will be treated as separate performance obligations.

Promised goods and services represent separate performance obligations if the goods or services are:

- Distinct (by themselves or as part of a bundle of goods and services)
- Or
- Part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer

A good or service (or bundle of goods and services) is distinct if the customer can benefit from the good or service on its own or together with other readily available resources (i.e., the good or service is capable of being distinct) and the good or service is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract).

Section 4.2 of our general publication explores in further detail the requirements for determining whether a good or service is distinct, whether the transfer of a good or service represents a separate performance obligation and/or whether (and when) they need to be bundled.

5.1 Series of distinct goods and services that are substantially the same and have the same pattern of transfer

During development of the standard, respondents raised questions about how certain types of promised goods or services that are transferred consecutively to a customer will be treated. Some respondents thought it was unclear whether a three-year service or supply contract would be accounted for as a single performance obligation, or a number of performance obligations covering smaller time periods (e.g., yearly, quarterly, monthly, daily). Examples of such arrangements include a long-term service contract or a contract to deliver a number of identical goods (e.g., long-term supply contracts, take-or-pay arrangements).

To address these questions, the Boards clarified that even if a good or service is determined to be distinct, if that good or service is part of a series of goods and services that are substantially the same and have the same pattern of transfer, that series of goods or services is treated as a single performance obligation. However, before such a treatment could be applied, the standard requires that both of the following criteria are also met:

- Each distinct good or service in the series that the entity promises to transfer consecutively to the customer must represent a performance obligation that will be satisfied over time, in accordance with IFRS 15.35 (see Section 8 below).
- The entity would measure its progress toward satisfaction of the performance obligation using the same measure of progress for each distinct good or service in the series (see Section 8 below).
In the Basis for Conclusions, the Board indicates that this requirement was intended for repetitive service contracts. However, because the Basis for Conclusions uses an electricity contract as one example, some entities are discussing whether this notion could apply to some other commodity supply arrangements.

Mining and metals entities will need to assess their long-term contracts to supply a commodity (e.g., a take-or-pay arrangement) to determine whether any of the criteria for recognition over time are met. However, it is clear that in order to treat such an arrangement as a single performance obligation, the distinct goods or services within the series (e.g., each unit of commodity) would need to individually meet one of the criteria to be satisfied over time and have the same measure of progress.

Given this, it seems unlikely such a provision could be applied to take-or-pay arrangements. We discuss such arrangements in more detail in Section 9.

5.2 Customer options for additional goods or services
Some sales contracts give customers the option to purchase additional goods or services. These additional goods and services may be priced at a discount or may even be free of charge.

The standard states that when an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

If the price for the optional goods or services reflects the stand-alone selling price for those goods or services (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than to have granted a material right. In such a situation, the entity will recognise revenue for the additional goods or services when the option is exercised and the entity provides those goods or services to the customer. This concept is discussed in Example 50 in the Illustrative Examples to IFRS 15. Refer to Section 4.6 of our general publication for more information.

An entity that determines that an option is a separate performance obligation within a contract will need to determine the stand-alone selling price of the option. If the option’s stand-alone selling price is not directly observable, the entity will estimate it, taking into consideration the discount the customer would receive in a stand-alone transaction and the likelihood that the customer would exercise the option.
IFRS 15 provides a practical alternative to estimating the stand-alone selling price of an option if that amount is not observable. This alternative applies when the goods or services are both: (1) similar to the original goods and services in the contract; and (2) provided in accordance with the terms of the original contract. The standard indicates this alternative will generally apply to options for contract renewals. Under this alternative, instead of valuing the option itself, an entity may assume the option will be exercised, by including the optional additional goods and services with the performance obligations already identified in the contract and including the consideration related to the optional goods or services in the estimated transaction price.

If an option is considered a separate performance obligation, there is currently some debate as to how the option should be accounted for once it is exercised. At their March 2015 meeting, the TRG considered three views:

1. The exercise is considered to be a continuation of the original contract, so the entity would include the amount allocated to the material right in the transaction price for the performance obligation underlying such a right.

2. The exercise is considered to be a contract modification and therefore the entity would apply the requirements relating to contract modifications (which we discuss in more detail in Section 3.3. of our general publication).

3. Any potential additional consideration upon exercise of the option should be treated as variable consideration subject to the constraint requirements.

TRG members thought the exercise of the option could be accounted for as a continuation of the original contract, or a contract modification, depending on which approach is most appropriate, in light of the facts and circumstances, and that the approach should be consistently applied to similar contracts. The TRG did not think that treating the exercise as a variable consideration was supportable by the standard.\footnote{14}

We discuss the implications of these requirements further in Section 9 with respect to take-or-pay arrangements for which there may be an option for goods in addition to the minimum specified quantity.

5.3 Principal versus agent

When identifying performance obligations, there may be some arrangements for which an entity needs to determine whether it is acting as principal or agent. This will be important as it affects the amount of revenue the entity recognises. That is, when the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled. When the entity is the agent, the revenue recognised is the net amount the entity is entitled to retain in return for its services as the agent. The entity’s fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

5.3.1 Royalty payments and other payments to mineral owners

Mining and metals entities frequently enter into royalty arrangements with owners of mineral rights (e.g., governments or private land owners). These royalties are often payable upon the extraction and/or sale of mineral ore. The royalty payments may be based on a specified rate per unit of the commodity (e.g., tonne or ounce) or the entity may be obliged to dispose of all of the...
relevant production and pay over a specified proportion of the aggregate proceeds of sale, often after deduction of certain extraction costs.

There are also other types of arrangements, which may be referred to as royalty payments/arrangements, but may potentially represent a different type of arrangement. Under these arrangements the royalty holder may have retained (or obtained) a more direct interest in the underlying production and may undertake mineral extraction and sale arrangements independently.

The issue is how to account for these amounts.

What’s changing from current IFRS?

The current accounting treatment for government and other royalties payable is diverse. Historically, many entities have presented revenue net of those royalties that are payable in kind. This is on the basis that the entity has no legal right to the royalty product and, hence, never received any inflow of economic benefits from those volumes. However, where the entity is required to sell the physical product in the market and remit the net proceeds (after deduction of certain costs incurred) to the royalty holder, they may be exposed to the risks and rewards of ownership to such an extent that it is appropriate to present revenue on a gross basis and include the royalty payment within cost of sales or taxes (depending on how the royalty is calculated).

It is unclear whether, and how, such arrangements may be impacted by IFRS 15. In situations where the royalty holder retains or obtains a direct interest in the underlying production, it may be that the relationship between the mining entity and royalty holder is more like a collaborative arrangement (and, hence, is not within the scope of IFRS 15).

However, the requirements relating to principal versus agent in IFRS 15 may also be helpful in assessing how such amounts should be presented if they are in scope. As noted in the standard, for the entity to conclude it is acting as the principal in the arrangement, the entity must determine that it controls the goods or services promised to the customer before those goods and services are transferred to the customer. Because this determination is not always clear, the standard provides indicators to assist the entity in making this determination.

While the indicators are similar to those in current IFRS, they reflect concepts included in the new standard such as identifying performance obligations and the transfer of control of goods or services. Appropriately identifying the entity’s performance obligation in a contract is fundamental to the determination of whether the entity is acting as agent or principal.

With respect to these royalty payments (if they are not part of a collaborative arrangement and therefore out of scope), an entity will need to determine whether it obtains control of all of the underlying mineral ore once extracted, sells the product to its customers and then remits the proceeds to the royalty holder. If so, the mining entity will be considered to be acting as the principal and, hence, would recognise the full amount as revenue with any payments to the royalty holder being recognised as part of cost of goods sold. Where the entity does not obtain control over those volumes, it may be acting as the royalty holder’s agent and extracting the ore on its behalf.
How we see it

Consistent with current practice, entities will need to carefully evaluate how to account for royalty and other similar arrangements. IFRS 15 includes application guidance on determining whether an entity is principal or agent in an arrangement that is similar to current IFRS. Entities may, therefore, reach similar conclusions to those under current IFRS. However, the standard includes the notion of considering whether an entity has control of the goods or services as part of the evaluation, which adds an overarching principle for entities to evaluate in addition to the indicators. This may affect the assessment of whether an entity is principal or agent in an arrangement.

A number of issues relating to principal versus agent have been raised with the TRG because of the diverse interpretations that are arising. As a consequence, the Boards directed their staff to undertake additional research and outreach and this paper was discussed at the TRG’s January 2015 meeting and at the Boards’ joint meeting in March 2015. The staff will continue to research possible changes to the principal versus agent (gross versus net) application guidance and bring these issues back to a future Board meeting. Given this, entities should continue to monitor these developments.15

5.3.2 Shipping terms - identification of performance obligations

Given the location of the commodities produced in the mining and metals sector, they generally have to be shipped to the customer. Such transportation may occur by road, rail or sea. The terms associated with shipping can vary depending on the method of shipping and the contract.

What’s changing from current IFRS?

With respect to the potential impact of IFRS 15, there are a number of factors to consider in relation to shipping terms linked to customer contracts. Specifically, mining and metals entities will need to assess the common shipping terms and conditions to determine the impact on:

- Control – these terms may impact the assessment of when the good is considered to transfer to the customer, i.e., when control passes (refer Section 8 and 8.1.2 of this publication for further discussion on control)

- Identification of performance obligations – the question has arisen as to whether the provision of shipping services represents a separate performance obligation or simply one of the underlying tasks that supports the transfer of control of the goods to the customer and is a cost of fulfilling the contract

At this stage, it is unclear how the requirements of IFRS 15 will impact shipping terms and appears to be a sensitive issue where there are diverse views. It had been raised with the TRG and was discussed at their January 2015 meeting and was then considered by the Boards at their February 2015 meeting.

15 Our IFRS Developments and Applying IFRS summarising these discussions are available on www.ey.com/ifrs
At the February meeting, the FASB tentatively decided to clarify the guidance in its standard on revenue as it applies to shipping and handling activities. The revised guidance would clarify that shipping and handling activities that occur before the customer obtains control of the related good are fulfilment activities. In addition, the FASB tentatively decided to permit an entity, as an accounting policy election, to account for shipping and handling activities that occur after the customer has obtained control of a good as fulfilment activities. The IASB did not vote on whether to make any changes in this area. The FASB’s tentative changes will be subject to the Boards’ due process, including an exposure document for public comment.\textsuperscript{16}

**How we see it**

The change from the risk and reward model under current IFRS to a control model under IFRS 15 and the concept of separate performance obligations, as well as the specific issues being considered by the TRG and the Boards, will require mining and metals entities to closely examine their customer contracts and the associated shipping terms to determine whether there will be any impact on how and when revenue is recognised.

It is unclear what impact the tentative decisions made by the FASB at the February meeting will have on this issue, particularly as the IASB did not vote on whether to make any changes. Therefore, mining and metals entities will need to continue to closely monitor any future discussions or developments in this area.

5.4 Sale of product with delayed shipment (bill-and-hold arrangements)

A mining and metals entity may enter into a sales contract whereby the purchaser pays a significant portion (or all) of the final estimated purchase price but then requests delayed shipment, for example, because of limited storage space. These sales can sometimes be referred to as ‘in-store sales’, or more generally as ‘bill-and-hold arrangements’.

Under the current guidance provided in the Illustrative Examples to IAS 18, revenue is recognised when the buyer takes title, provided that: it is probable the delivery will be made; the product is on hand, it is specifically identified as belonging to the purchaser and is ready for delivery; the purchaser specifically acknowledges the deferred delivery instructions; and the usual payment terms apply.\textsuperscript{17}

**What’s changing from current IFRS?**

The application guidance in IFRS 15 specifically addresses bill-and-hold arrangements, and the requirements are largely the same as those in in IAS 18. IFRS 15 states that an entity will need to determine when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product (refer Section 7.2 of our general publication and Section 8.1 of this publication for the general control considerations). In addition to applying these general requirements, an entity must also meet the criteria to be able to demonstrate control has passed for a bill-and-hold arrangement.

\textsuperscript{16} Our IFRS Developments and Applying IFRS summarising these discussions are available on www.ey.com/ifrs
\textsuperscript{17} IAS18.IE1
IFRS 15 also states that even if an entity recognises revenue for the sale of a product on a bill-and-hold basis, it will also need to consider whether it has remaining performance obligations (e.g., for custodial services or security services) to which the entity will need to allocate a portion of the transaction price, as discussed in Section 7 below.

How we see it
The criteria for determining whether a bill-and-hold transaction qualifies for revenue recognition under IFRS 15 are similar to current IFRS. However, consideration of a separate custodial/security performance obligation may be a change for some entities. Depending on how entities have previously accounted for such transactions, this may impact their revenue recognition profiles.

6. Determine the transaction price
The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (e.g., some sales taxes\(^\text{18}\)). When determining the transaction price, an entity should consider the effects of all of the following: (1) variable consideration (including any related constraint); (2) a significant financing component (i.e., the time value of money); (3) non-cash consideration; and (4) consideration payable to a customer.

In many cases, the transaction price is readily determinable because the entity will receive payment at or near the same time as it transfers the promised good or service and the price is fixed for the minimum committed purchases. However, determining the transaction price may be more challenging when it is variable in amount, when payment is received at a time that is different from when the entity provides the goods or services and the effect of the time value of money (i.e., a financing component) is significant to the contract, or when payment is in a form other than cash.

6.1 Variable consideration
The standard provides examples of factors that can cause the transaction price of a contract to vary, including discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. Another way in which the transaction price can vary, considered in Illustrative Example 25 to the standard, is if the price for each unit is variable (e.g., it is based upon or linked to a market price or some other variable price).

If the transaction price is variable, an entity is required to estimate the transaction price using either an ‘expected value’ or a ‘most likely amount’ approach. An entity is required to make that decision based on the approach that better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a ‘free choice’. Rather, an entity selects the method that is best suited, based on the facts and circumstances of each contract.

\(^{18}\) The issue of the presentation of sales taxes was raised with the TRG. At the Boards’ March 2015 joint meeting, the FASB decided to add a practical expedient that would allow an entity to present revenue net of certain types of taxes with disclosure of the policy. The IASB decided that a practical expedient is not necessary as the topic was not an interpretative question, but a concern expressed by stakeholders in the US as to the operability of the requirements under US GAAP.
6.2 Constraint on revenue
While IFRS 15 requires entities to estimate variable consideration, it also requires entities to limit the amount of variable consideration it can include in the transaction price. Specifically, variable consideration is limited to the amount for which it is highly probable that a significant revenue reversal will not occur when the uncertainty associated with the variability is subsequently resolved. That is, the standard requires an entity to apply a constraint on variable consideration.

For sales and usage-based royalties from licences of intellectual property, IFRS 15 states that an entity only includes the consideration from such royalties in the transaction price at the later of when the subsequent sales or usage occurs or the performance obligation to which the royalty relates has been satisfied. As a reminder, this requirement does not apply to sales and usage-based royalties from other types of sales or licences, such as those from mineral interests.

Further information on determining the transaction price, including variable consideration, is set out in Section 5 of our general publication.

There are specific considerations in determining the transaction price, particularly with respect to financing components and the constraint on variable consideration, which are relevant to take-or-pay arrangements. We discuss these further in Section 9 below.

7. Allocate the transaction price to the performance obligations
Once the performance obligations have been identified and the transaction price has been determined, an entity is required to allocate the transaction price to the performance obligations, generally in proportion to their stand-alone selling prices (i.e., on a relative stand-alone selling price basis), with limited exceptions. An entity will need to allocate variable consideration to one or more, but not all, performance obligations in some situations (as discussed in Section 7.2 below). The standard also contemplates the allocation of any discount in a contract to one or more, but not all, performance obligations, if specified criteria are met.

7.1 Estimating the stand-alone selling price
When determining stand-alone selling prices, an entity is required to use observable information, if available. If stand-alone selling prices are not directly observable, an entity will need to make estimates based on information that is reasonably available. Possible estimation approaches referenced in the standard include an adjusted market assessment approach or an expected cost plus a margin approach. The standard also permits the use of a residual value approach, but only in limited circumstances. An entity is required to apply estimation methods consistently in similar circumstances. The transaction price is not reallocated to reflect changes in stand-alone selling prices after contract inception.

Section 6.1 of our general publication provides more details about how an entity determines a stand-alone selling price.
7.1.1 Long-term contracts – determining the stand-alone selling price

When estimating the stand-alone selling price, there is some uncertainty as to how the requirements will be applied to contracts that involve the satisfaction of performance obligations over a long period of time. Specifically, at contract inception, how does an entity determine the stand-alone selling price of a performance obligation to be satisfied in the future?

For example, if a long-term take-or-pay contract involves the delivery of 3,000 metric tonnes (mt) of coal over a three-year period and each mt is a separate performance obligation, is the price of a mt of coal to be sold and delivered today different than a mt of coal an entity expects to sell and deliver in three years’ time? If the contract involves a commodity to be delivered in a location with a liquid market price, such as gold bullion, does the forward commodity price curve represent the observable price for expected deliveries in future periods? We explore the potential impact of this question in Section 9.1.4 below.

7.2 Allocating variable consideration

In an exception to the relative stand-alone selling price method of allocating the transaction price, the standard requires variable consideration to be allocated entirely to a specific part of a contract if certain criteria are met. For example, it may be allocated to one or more (but not all) performance obligations in the contract or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that form part of a single performance obligation. The criteria require that the terms of the variable payment relate specifically to the entity’s efforts to satisfy the performance obligation (or transfer the distinct good or service) and the allocation be consistent with the objective of allocating the transaction price to depict the amount of consideration an entity expects to be entitled to in exchange for transferring the goods or services in the contract. The standard allows for this exception to be applied to a single performance obligation, a combination of performance obligations or distinct goods or services that make up part of a performance obligation.

We discuss the implications of these requirements with respect to take-or-pay arrangements in Section 9.

8. Satisfaction of performance obligations

An entity recognises revenue only when it satisfies a performance obligation by transferring control of a promised good or service to the customer. Control may be transferred over time or at a point in time. A performance obligation is satisfied at a point in time unless it meets one of the following criteria to be satisfied over time:

- The customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs
- The entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced
- The entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date
When a performance obligation is satisfied over time, the standard requires an entity to select a single method, either an input method or an output method, to measure progress for each performance obligation that best depicts the pattern of the entity’s performance in transferring the good or service.

Further information on the satisfaction of performance obligations and recognising revenue is set out in Section 7 of our general publication.

8.1 Transfer of control
Under IFRS 15, control is referred to as the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control also includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. For performance obligations satisfied at a point in time (as opposed to being satisfied over time), the standard provides some indicators of when control has passed. These include:

- The entity has a present right to payment for the asset
- The customer has legal title to the asset
- The entity has transferred physical possession of the asset
- The customer has the significant risks and rewards of ownership of the asset
- The customer has accepted the asset

8.1.1 Gold bullion sales
When mining and metals entities sell gold bullion, there is generally a period of time (usually a matter of days) between when the bullion leaves the mine site with the security shipper and when the gold is credited to the metal account of the customer. In the intervening period, the gold bullion is sent to the refinery where it is refined, ‘out turned’, and, finally, transferred or credited to the customer’s metal account.

For some entities, revenue is currently being recognised on such gold bullion sales when the bullion leaves the mine site with the security shipper on the basis that the risks and rewards associated with ownership of the bullion have passed.

What’s changing from current IFRS?
Under IFRS 15, revenue is recognised only when the identified performance obligation is satisfied by transferring the promised good or service to the customer. A good or service is transferred when the customer obtains control of that good or service.

At the time when the gold bullion leaves the mine site, given the ways these transactions are commonly structured, the customer may not control the bullion and the above indicators that control has passed may not be present. That is, the customer may not have the ability to direct the use of, or receive the benefit from, the gold bullion. Instead, these indicators may only be present when the gold bullion is actually credited to the customer’s metal account.

8.1.2 Shipping terms – impact on control
As discussed earlier at Section 5.3.2, most customer contracts require a mining and metals entity to deliver the goods to the customer, but the specific shipping terms may vary by contract. As noted, an entity will need to assess the shipping terms within each type of contract in light of the indicators of control to
determine when control passes to the customer. Also, as this is an issue that has been raised with the TRG and has been considered by the Boards at their February 2015 meeting, entities should continue to monitor the progress of future discussions to determine whether there will be any impact on the assessment of shipping terms and the transfer of control.21

It is also worth noting that there may be some shipping arrangements where title to the goods must pass to the carrier during transportation, but the related contract includes a clause that requires the carrier to sell the goods back to the mining and metals entity at the same price. We discuss the impact of repurchase clauses in Section 8.2 below.

How we see it

The change from a risk and reward model under IAS 18 to a control model under IFRS 15 may provide greater clarity as to when revenue would be recognised. Entities will need to carefully re-examine the terms of their contracts, including shipping terms, to assess whether this will impact the timing of revenue recognition.

8.2 Repurchase agreements

Some agreements include repurchase provisions, either as part of a sales contract or as a separate contract that relates to the goods in the original agreement or similar goods. The application guidance to IFRS 15 clarifies the types of arrangements that qualify as repurchase agreements. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset or another asset of which the asset that was originally sold is a component.

IFRS 15 specifically notes that repurchase agreements generally come in three forms:

- An entity’s obligation to repurchase the asset (a forward)
- An entity’s right to repurchase the asset (a call option)22
- An entity’s obligation to repurchase the asset at the customer’s request (a put option)

With respect to the first two (i.e., a forward or call option held by the entity), the standard is clear that the customer has not obtained control of the asset and, therefore, revenue cannot be recognised when the goods transfer to the customer. Instead, such transactions will be accounted for as financing arrangements or leases, depending on the relationship between the repurchase price and the original selling price. If the entity has the right or obligation to repurchase the asset at a price equal to or greater than the original sales price (considering the effects of the time value of money), the entity will account for it as a financing arrangement. If the entity has the right or obligation to repurchase the asset at a price less than the original sales price (taking into consideration the effects of the time value of money), the entity will account for the transaction as a lease in accordance with IAS 17, unless the contract is part of a sale and leaseback transaction.

21 Our IFRS Developments summarising these discussions is available on www.ey.com/ifrs
22 Our IFRS Developments summarising these discussions is available on www.ey.com/ifrs
If a transaction is considered a financing arrangement, the selling entity will continue to recognise the asset (i.e., the inventory). In addition, it will record a financial liability for any consideration received from the customer. The difference between the consideration received from the customer and the consideration subsequently paid to the customer (upon repurchasing the asset) represents interest and processing or holding costs (as applicable) that are recognised over the term of the financing arrangement. If the option lapses unexercised, the entity derecognises the liability and recognises revenue at that time.

With respect to the third type of repurchase agreements (i.e., a written put held by the customer), an entity will need to undertake further analysis to determine whether the customer has a significant economic incentive to exercise the option. This will then determine whether revenue is recognised in this situation.

Refer Section 7.3 of our general publication for more details on repurchase agreements.

8.2.1 Tolling arrangements with a repurchase agreement

Mining and metals entities often provide raw material to a smelter or refiner for further processing. These are often referred to as tolling arrangements. In some instances, the entity may sell the raw material to the smelter or refiner, but, at the same time, enter into a repurchase agreement for the finished product.

There is limited guidance in current IFRS with respect to repurchase agreements. IAS 18 requires an entity to consider a repurchase agreement together with the original sales agreement when they are linked in such a way that the substance of the arrangement cannot be understood without reference to the series of transactions as a whole. Illustrative example 5 to IAS 18 addresses sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods. IAS 18 states that, where risks and rewards have not passed to the customer, the transaction is treated as a financing arrangement. However, IAS 18 provides no further guidance on the appropriate accounting treatment. Therefore, divergent treatments may have arisen in practice.

What's changing from current IFRS?

While the requirements in IFRS 15 are consistent with current IFRS, the application guidance in IFRS 15 will provide greater clarity on how to account for such arrangements. Specifically, in tolling arrangements for which a mining entity has a right or obligation to repurchase the product, revenue cannot be recognised when the goods are transferred to the smelter/refiner. This is because the smelter/refiner is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset (i.e., it does not have control) even though it may have physical possession of the asset.

In most tolling arrangements, it is likely the repurchase price will be equal to or greater than the original sales price (considering the effects of the time value of money). Therefore, the entity will continue to account for these as financing arrangements.

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23 IAS 18.13 and SIC-27
8.2.2 Shipping arrangements with a repurchase agreement
As noted above, if any shipping arrangements have related repurchase clauses, the application guidance in IFRS 15 on repurchase agreements will apply and may affect an entity’s assessment of when control passes to the customer.

How we see it
We believe the requirements for repurchase agreements could result in a change in practice for some entities given the limited guidance in current IFRS.

Entities may find the requirements challenging to apply in practice because the standard contains the same requirements for all forwards and call options and does not allow entities to contemplate the likelihood of exercise of an option.

9. Take-or-pay arrangements
As previously mentioned, a take-or-pay arrangement is a supply agreement between a customer and a supplier in which the pricing terms are set for a specified minimum quantity of a particular good or service and the price is payable irrespective of whether the good or service is taken by the customer.

While take-or-pay arrangements tend to be more common in other industries, such as the oil and gas and power and utilities industries (and may involve the supply of gas, pipeline capacity or electricity as examples), they can also be found in the mining and metals sector (e.g., coal). These arrangements can be long term in nature and may contain terms and conditions with varying degrees of complexity (e.g., simple fixed pricing, stepped pricing or variable pricing).

In addition, for payments made in relation to volumes not taken (i.e., where the customer does not take the minimum quantities specified) the terms may vary. For example, some take-or-pay arrangements may include a clause that allows the customer to ‘make-up’ the volumes not taken at a later date. The ability to make-up the unused volumes means that consideration has been received in advance by the producer for product that has not yet been delivered to the customer. Alternatively, the arrangement may contain a ‘use it or lose it’ clause, where the customer cannot make-up the unused volumes in the future.

Under current IFRS, revenue is recognised, as follows:

a) Volumes taken: revenue is recognised when the volumes of the product concerned (e.g., coal) are actually delivered and they are measured at the amount invoiced to the customer based upon the applicable price at that time (e.g., market price or fixed price as specified in the contract).

b) Volumes not taken, but paid for:
   No entitlement to make-up volumes: revenue is recognised at the expiration of the stated take-or-pay period (e.g., every 12 months).
   Customer is entitled to make-up volumes: the amount paid by the customer is recognised as deferred/unearned revenue, and is recognised as revenue either when the payment is applied to future deliveries or the right to apply the payment to such deliveries expires unused. Interest is generally not accrued on such amounts.
What's changing from current IFRS?

Given the length and complexity of these long-term take-or-pay arrangements, it may be difficult to initially determine the impact IFRS 15 will have on the financial statements. In the discussion that follows, we consider how the steps of the revenue recognition model may apply to take-or-pay arrangements.

9.1 Analysing the arrangements under the model in IFRS 15

To illustrate the application of the model to take-or-pay arrangements, we have selected two primary types of arrangements – one with a fixed price and the other with a variable price. For the fixed price contract, we have two scenarios – one where the price is fixed for the life of the contract and the other where the fixed price steps up each year of the contract.

For the purposes of these scenarios, we use the following fact pattern:

<table>
<thead>
<tr>
<th>Illustration 9-1 — Take-or-pay terms and conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terms</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>Length of contract</td>
</tr>
<tr>
<td>Minimum volumes</td>
</tr>
</tbody>
</table>
| Price per tonne | CU1,000 | Year 1 – CU500  
Year 2 – CU1,000  
Year 3 – CU1,500 | VWAP** in week prior to delivery of coal |

** VWAP – volume weighted average price  
mt = metric tonnes

9.1.1 Step 1: Identifying the contract

As discussed in section 4.1, the contract will generally be the minimum amount specified. The impact of options for volumes above the minimum is discussed in section 9.1.2.

9.1.2 Step 2: Identifying the performance obligations

In a take-or-pay arrangement for coal, an entity would generally conclude that each metric tonne (mt) of coal is a distinct good. Therefore, each mt of coal would represent a separate performance obligation that is satisfied at a point in time. Because such goods are transferred at a point in time, they would not meet the criteria to be considered a series of distinct goods that would have to be treated as a single performance obligation.

Options to acquire additional goods

Some take-or-pay arrangements may provide a customer with an option to buy additional goods. These optional additional goods are often priced at the same rates as the minimum volumes.

An option for additional goods will ordinarily have to be assessed to determine whether it represents a material right that has to be accounted for as a separate performance obligation for that contract. In such a situation, if an option does not result in a discount that the customer would not receive without entering into the contract (i.e., it does not exceed the discounts typically given for those goods to that class of customer in that geographical area or market), it will not represent a material right. Instead, it will be considered a marketing offer and the revenue associated with such additional goods will be recognised when those additional goods are taken by the customer.
However, should the pricing terms for the additional goods be lower than those applicable to the minimum volumes, the entity will have to assess whether they represent a material right (and, hence, a separate performance obligation).

9.1.3 Step 3: Determining the transaction price
Step 3 is to determine the transaction price of the contract.

Fixed price contracts
For a fixed price contract, this step will be relatively straightforward:

<table>
<thead>
<tr>
<th>Contract type</th>
<th>Calculation</th>
<th>Total transaction price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed price (life of contract)</td>
<td>3 yrs x 1,000 mt x CU1,000</td>
<td>CU3,000,000</td>
</tr>
<tr>
<td>Stepped fixed price</td>
<td>Yr 1 = 1,000 mt x CU500 = CU500,000</td>
<td>CU3,000,000</td>
</tr>
<tr>
<td></td>
<td>Yr 2 = 1,000 mt x CU1,000 = CU1,000,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Yr 3 = 1,000 mt x CU1,500 = CU1,500,000</td>
<td></td>
</tr>
</tbody>
</table>

Variable price contracts
For variable price contracts, determining the transaction price may appear to be significantly more complex than for a fixed price contract. Depending on the terms of the arrangement, this may not even be possible at contract inception, e.g., if the price the customer pays is based on or derived from a market price at or near the date of delivery. However, the specific requirements relating to variable consideration may mean that, in such situations, estimating the transaction price at contract inception may not be required if the amount is fully constrained.

Sections 6.1 and 6.2 above discuss variable consideration and, in particular, the requirements relating to the constraint. This requirement limits the amount of variable consideration an entity can include in the transaction price to the amount for which it is highly probable that a significant revenue reversal will not occur when the uncertainty associated with the variability is subsequently resolved.

With such variable pricing terms, an entity is likely to observe that the promised consideration at contract inception is dependent on the market and thus is highly susceptible to factors outside the entity’s influence. In addition, the future market price in relation to each mt of coal has a large number and a broad range of different possible amounts. The entity may also observe that although it has experience with similar contracts, that experience is of little predictive value in determining the future prices. Therefore, at contract inception, the entity is unlikely to be able to conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity tried to estimate the transaction price and therefore will fully constrain the transaction price.

Therefore, at each reporting date, the entity will need to update its estimate of the transaction price. Consequently, the entity may conclude it can then include the actual market price in the transaction price when received for the volumes delivered because that is when the related uncertainty is resolved.
9.1.4: Step 4 and Step 5: Allocating the transaction price to the performance obligations and recognising revenue

Step 4 of the model in IFRS 15 requires the transaction price to be allocated to the performance obligations. This requires an entity to:

- Determine the stand-alone selling price of each performance obligation
- Allocate the transaction price based upon the relative stand-alone selling prices

Then, in Step 5, an entity will recognise revenue once each performance obligation is satisfied.

As discussed in Section 9.1.2 above, it is likely that each mt of coal will be a separate performance obligation. Further, as noted in Section 7.1.1 above, it is unclear whether the stand-alone selling price of an identical unit (e.g., a mt of coal) to be sold repeatedly over a period of time, is determined at contract inception by looking at the price of a unit sold and delivered at inception (e.g., the spot price), the forward price (if observable and liquid) for a mt of coal to be sold and delivered in the future, or some other amount.

Using the spot price will result in an identical stand-alone selling price for each performance obligation (i.e., each mt of coal), whereas using the forward price or some other amount will result in a different stand-alone selling price for each mt of coal or groups of mt. This may impact the allocation of the transaction price, increase the complexity of applying the model and may ultimately impact the pattern of revenue recognition, unless the stand-alone selling price is determined to be consistent with the contract price(s).

To illustrate, assume the following forward prices for the future delivery of coal:

- Throughout year 1 = CU 600**
- Throughout year 2 = CU 1,100**
- Throughout year 3 = CU 1,600**

** We have assumed that the forward prices differ from the stepped prices stated in the contract.

While we have used the forward curve (without adjustment) as the stand-alone selling price in this example, this does not necessarily mean the forward curve will always be the stand-alone selling price. Such a determination will depend on how an entity estimates the amount that would result in the allocation of the transaction price in accordance with the allocation objective of the standard. That is, a method that allocates the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.
Spot price used for stand-alone selling price
Assume that the contract involves selling identical products (i.e., coal), and each mt of coal has the same stand-alone selling price at contract inception based on the spot price, regardless of when the coal is to be delivered. This will mean that each mt of coal will be allocated the same proportion of the transaction price, as follows:

<table>
<thead>
<tr>
<th>Contract type</th>
<th>Calculation</th>
<th>Relative stand-alone price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed price</td>
<td>CU3,000,000 / 3,000mt</td>
<td>CU1,000/mt</td>
</tr>
<tr>
<td>Stepped fixed price</td>
<td>CU3,000,000 / 3,000mt</td>
<td>CU1,000/mt</td>
</tr>
</tbody>
</table>

Forward curve used for stand-alone selling price
In this scenario, assume the stand-alone selling price of a mt of coal to be sold and delivered today is based on the forward curve, which has different values for a mt of coal to be sold and delivered in different periods. This means that the coal to be sold and delivered throughout year 1 will be allocated a different proportion of the transaction price to the coal to be sold and delivered throughout years 2 and 3. Given this, the coal sold throughout each of the various years will be allocated the following percentages of the total transaction price:

<table>
<thead>
<tr>
<th>Yr</th>
<th>Calculation</th>
<th>Total transaction price</th>
<th>Relative % of total (rounded)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CU 600 x 1,000mt</td>
<td>CU 600,000</td>
<td>18.181%</td>
</tr>
<tr>
<td>2</td>
<td>CU 1,100 x 1,000mt</td>
<td>CU 1,100,000</td>
<td>33.33%</td>
</tr>
<tr>
<td>3</td>
<td>CU 1,600 x 1,000mt</td>
<td>CU 1,600,000</td>
<td>48.485%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CU 3,300,000</td>
<td></td>
</tr>
</tbody>
</table>

Fixed price contract
In applying all of the information calculated above to a fixed price contract, the revenue recognition profile may be, as follows:

<table>
<thead>
<tr>
<th>IAS 18</th>
<th>IFRS 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yr</td>
<td>Spot price as stand-alone selling price</td>
</tr>
<tr>
<td></td>
<td>1,000mt x CU1,000</td>
</tr>
<tr>
<td>1</td>
<td>CU1,000,000</td>
</tr>
<tr>
<td>2</td>
<td>1,000mt x CU1,000</td>
</tr>
<tr>
<td>3</td>
<td>1,000mt x CU1,000</td>
</tr>
<tr>
<td></td>
<td>= CU1,000,000</td>
</tr>
<tr>
<td></td>
<td>CU3,000,000</td>
</tr>
</tbody>
</table>

In this scenario, assuming the spot price is the stand-alone selling price, the revenue recognition profile will likely be the same as that currently achieved under IAS 18. However, if the forward curve is used, the revenue recognition profile changes with the revenue in Year 1 being lower, the revenue in Year 2 being the same, and the revenue in Year 3 being higher, than that achieved under IAS 18 based on the prices used in this illustration.
Some may argue that, in such a fixed price contract, the revenue recognition profile that assigns different stand-alone selling prices in different periods accurately reflects the economic characteristics of the contract. That is, the entity is selling coal at a discount to the market in Years 2 and 3. Therefore, in the context of the contract, some of the cash paid by the customer in Year 1 is effectively a prepayment for coal that will be delivered in the future years. This circumstance may also lead the entity to evaluate whether the difference in the timing of payment and the amount of revenue recognised suggests there is a significant financing component, which could affect the transaction price. The example does not contemplate this additional consideration.

Stepped price contract

In applying all of the information calculated above to a stepped fixed price contract, the revenue recognition profile may be, as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Spot price as stand-alone selling price</th>
<th>Forward curve as stand-alone selling price</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 18</td>
<td>Forward curve as stand-alone selling price</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>CU500,000</td>
<td>1,000mt x CU1,000 = CU1,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>= CU3,000,000 x 18.181% = CU545,440</td>
</tr>
<tr>
<td>2</td>
<td>CU1,000,000</td>
<td>1,000mt x CU1,000 = CU1,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>= CU3,000,000 x 33.33% = CU1,000,000</td>
</tr>
<tr>
<td>3</td>
<td>CU1,500,000</td>
<td>1,000mt x CU1,000 = CU1,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>= CU3,000,000 x 48.485% = CU1,454,560</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CU3,000,000</td>
</tr>
<tr>
<td></td>
<td>IFRS 15</td>
<td>CU3,000,000</td>
</tr>
</tbody>
</table>

In this scenario, assuming the spot price is the stand-alone selling price, the revenue recognition profile differs from that currently achieved under IAS 18 because the revenue is spread evenly over the three years. Where the forward prices are the stand-alone selling prices and those amounts differ from that stated in the contract, the revenue recognition profile will also differ from that under IAS 18. These timing differences may require an entity to evaluate whether there is a significant financing component that must be considered when estimating the transaction price.

Variable price contract

To determine the appropriate allocation of the transaction price for contracts with variable pricing, mining and metals entities will need to consider the requirements to allocate variable consideration to one or more, but not all, performance obligations, provided the specific criteria are met.

Specifically, entities will need to evaluate whether the terms of the variable payment relate specifically to the entity’s efforts to satisfy the performance obligation or transfer the distinct good, and the allocation is consistent with the allocation objective of the standard (i.e., to allocate the transaction price to depict the amount of consideration an entity expects to be entitled in exchange for transferring the goods or services in the contract). If these two criteria are met, revenue will be recognised when control of each mt of coal is transferred to the customer at the variable price applicable at that time. This would lead to accounting similar to current practice.
How we see it
The above analysis demonstrates that:

• The identification of the performance obligations within a contract
• Decisions about how the stand-alone selling price(s) is determined
• The manner in which variable consideration (if any) is allocated

could either result in a different revenue recognition profile and increased complexity or could result in a revenue recognition profile that is the same or virtually the same as that currently achieved under IAS 18.

9.2 Other considerations

9.2.1 Volumes paid for, but not taken
Another feature unique to take-or-pay arrangements is the terms relating to payments made for volumes not taken, as explained earlier. The requirements of IFRS 15 may result in different accounting considerations and possibly different conclusions depending on the specific facts and circumstances of each arrangement.

Payments cannot be applied to future volumes
If payments received for unused volumes cannot be applied to future volumes, the seller has no further performance obligations (i.e., it has no obligation to deliver the unused volumes in the future). Therefore, such an amount can generally only be recognised as revenue once the seller’s obligations no longer exist (i.e., once the customer’s right to volumes has expired unused).

For most take-or-pay arrangements, such an assessment may only be possible at the end of a pre-defined period (e.g., the end of each contract year). This is because the customer’s rights have technically not expired and the entity is still obliged to deliver the volumes, if the customer requests them, until the end of the stated period. Also, the customer is not contractually obliged to pay the amount for the unused volumes until this time (i.e., the entity does not have an unconditional right to receive cash). This treatment is consistent with current practice.

The standard does, however, consider whether it may be possible to recognise revenue in relation to a customer’s unexercised rights earlier through the requirements relating to breakage. While we discuss this concept in more detail in Section 9.2.3, in summary, earlier recognition of revenue in relation to unexercised rights will require an entity to be able to demonstrate that it is not highly probable there will be a significant reversal of revenue in relation to the unexercised rights.

Payments can be applied to future volumes
If payments received for unused volumes can be applied to future volumes, the seller has received consideration in advance for some unsatisfied performance obligations (i.e., the delivery of the unused volumes at some point in the future). This amount represents a contract liability.
When a contract provides a customer with the possibility of make-up volumes, an entity will need to determine how such future volumes can be taken. That is, whether the timing of the future transfer of those volumes is at the discretion of the customer or is determined by the entity itself. This determination will be important as it may require an assessment of the time value of money (refer Section 9.2.2 for further discussion). It will also be necessary for the entity to understand whether the customer is likely to take its unused volumes as this may require an assessment of the requirements relating to unexercised customer rights (or ‘breakage’ as the standard refers to it) (refer Section 9.2.3 below for further information). This could impact the amount and timing of revenue recognised.

Such determinations will need to be made in light of the contract terms and an assessment of the expected customer behaviours. For example, such an assessment may involve considering whether the make-up volumes:

- Will be the first volumes to be taken at the start of the following period
- Can only be taken after the minimum volumes have been satisfied in the following periods

Or

- Can only be taken after a certain amount of time or at the end of the contract period

9.2.2 Impact of the time value of money

There may be certain situations where the time value of money may need to be considered. Firstly, this may occur when the amount of revenue recognised differs from the payments received from the customer under the contract. As discussed in Section 9.1.4 in relation to fixed and stepped price contracts, differences in views about how the stand-alone selling price is to be determined may impact revenue recognition. There may be situations where a customer pays an amount in excess of, or less than, the amount of revenue recognised for a performance obligation. This will result in the entity recognising either a contract liability or contract asset. Secondly, this may occur when a customer is entitled to make up volumes and the mining and metals entity determines if, and when, those volumes have to be taken.

The standard requires the transaction price to be adjusted to reflect the time value of money if the contract has a financing component that is significant to the contract. It then provides various factors to consider when determining whether a financing component is significant.

IFRS 15 does, however, provide a practical expedient. It does not require an adjustment for the time value of money if the entity expects that the period between when the entity transfers a promised good or service to the customer and when the customer pays for that good or service will be one year or less. It also specifies that if a customer pays in advance and the timing of the future transfer of those goods or services is at the discretion of the customer, the contract will not have a significant financing component.\(^24\)

If it is determined that the time value of money is significant, an entity will need to adjust any contract asset or contract liability and recognise the related interest expense or income.

\(^{24}\) IFRS 15.62(a)
Under current IFRS, there is diversity in practice as to whether and how the impact of the time value of money is considered or incorporated. Therefore, the impact of adopting IFRS 15 may be significant for those contracts for which it is determined that the time value of money is significant.23

9.2.3 Breakage (customers’ unexercised rights)

IFRS 15 discusses the situation where, in certain industries, customers may pay for goods or services in advance, but may not ultimately exercise all of their rights to these goods or services – either because they choose not to or are unable to. IFRS 15 refers to these unexercised rights as ‘breakage’.

This may apply to take-or-pay arrangements, for which payments are received in relation to make-up volumes and the customer’s rights remain unexercised. Such breakage provisions may be applicable if:

- A customer is unable to use the make-up volumes in other areas of its own operations
- A customer is unable to store the make-up volumes and use them after the take-or-pay contract has expired
- A customer is unable to take delivery of the make-up volumes and sell them into the market

Or

- There are limitations (physical or contractual) that prevent the customer from taking all of the make-up volumes

The standard requires that when an entity receives consideration that is attributable to a customer’s unexercised rights, the entity is to recognise a contract liability equal to the amount prepaid by the customer (because the entity has not yet satisfied the performance obligations to which the payment relates).

However, since the entity may not be required by customers to fully satisfy its performance obligations, IFRS 15 states that when an entity expects to be entitled to a breakage amount, the expected breakage will be recognised as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, breakage amounts will only be recognised when the likelihood of the customer exercising its right becomes remote.

In determining whether an entity expects to be entitled to a breakage amount, it will need to consider the requirements relating to the constraint on revenue (which is discussed in more detail in Section 6.2). That is, in order to be entitled to a breakage amount, an entity would need to be able to demonstrate it is probable that a significant revenue reversal in the amount of cumulative revenue recognised will not occur when the uncertainty related to the customers unexercised rights is resolved.

For take-or-pay arrangements, this may mean that an entity may be able to recognise revenue in relation to breakage amounts in an earlier period, provided it can demonstrate it is not required to constrain its estimate of breakage. This could potentially occur in several ways:

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23 At its January and March 2015 meetings, the TRG considered a number of implementation issues on the requirements for significant financing components. Mining and metals entities may wish to monitor any future discussions or developments in this area. Our IFRS Developments and Applying IFRS summarising these discussions are available on www.ey.com/ifrs
1. At inception of the contract, the mining and metals entity may be able to reliably estimate the amount of breakage and would include that amount in the transaction price and allocate that to expected actual usage.

For example, if the minimum amount of coal for a contract is 1,000mt at CU10/mt (and, hence, total revenue for the contract is expected to be CU10,000) and the entity estimates at contract inception that the customer will only take 900mt (and, hence, the entity will be entitled to the breakage amount in relation to 100 mt not taken), then as the entity delivers the 900mt, the amount of revenue for each mt of coal delivered will be recognised at the higher amount of CU11.11/mt (being CU10,000 / 900mt).

During the contract, the entity may revise its estimate of expected breakage. In that case, it would adjust its revenue recognition pattern for the breakage amount to reflect the updated estimate.

2. If the entity cannot estimate an amount of breakage, it will recognise the revenue associated with those unexercised rights when it becomes remote that they will be exercised. This could occur during a make-up period after the initial term of the contract or when the deficiency make-up period expires outright (which would be consistent with current accounting).

Assume that after the initial term of the contract, the customer has taken all but 400mt and is still expected to take another 300mt during the make-up period, but it is remote that the customer will use the remaining 100mt. The entity may recognise revenue for the 100mt. However, it is not clear whether a portion of the amount of revenue relating to those 100mt should be allocated to the 300mt that the customer will still use, but that have not yet been delivered – similar to (1) above. Alternatively, if the entity could not determine whether the 100mt would be made up, it would delay revenue recognition until the make-up period expires.

It is also possible that, given the nature of these arrangements and the inherent uncertainty in being able to predict a customer’s behaviour, it may be difficult to satisfy the requirements relating to constraint because the entity’s experience may not be predictive of the outcome at this level of certainty (i.e., highly probable).

How we see it

Application of the requirements in IFRS 15 may increase the complexity in accounting for take-or-pay arrangements in which the customer is entitled to make-up volumes.

In certain situations, an entity may need to assess whether a significant financing component needs to be incorporated in the transaction price. If it does, the entity will need to have the appropriate processes and systems in place to be able to calculate and recognise the associated interest expense or income. Likewise, entities will need to understand the point at which any amounts that have previously been recognised as contract liabilities can be recognised as revenue.

While it may be possible for an entity to apply the breakage requirements and recognise revenue earlier than under current IFRS, robust evidence will be needed to support such a treatment and the requirements relating to constraint will need to be appropriately considered.
10. Next steps

We encourage mining and metals entities to obtain a detailed understanding of IFRS 15 so they are able to evaluate how it may affect their specific revenue recognition policies and practices.

Entities should consider whether they will need to make any changes to their accounting policies, accounting systems and processes or internal controls over financial reporting.

Entities may also wish to monitor the discussions of the Boards, the TRG, as well as the various industry task forces that have been formed by the American Institute of Certified Public Accountants (AICPA) to discuss the application of the new standard to common transactions within those industries. Any guidance produced by the AICPA is non-authoritative.26

Entities should also consider how they will communicate the changes with investors and other stakeholders, including their plan for disclosures about the effects of IFRS 15 required by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Entities’ disclosures should evolve in each reporting period as more information becomes available.

26 For more information see http://www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/revenuerecognition.aspx
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