No. 2014-28
27 August 2014

Technical Line

FASB — final guidance

The new revenue recognition standard — mining and metals

It may be challenging to determine whether counterparties to mining and metals contracts are customers.

What you need to know

- The new revenue recognition standard is more principles-based than current guidance and will require mining and metals entities to exercise more judgment.
- Mining and metals entities may find it challenging to determine whether counterparties in certain mining and metals arrangements are customers. They also may find it difficult to evaluate the effects of various pricing terms and to account for take-or-pay and other long-term supply arrangements.
- Mining and metals entities may have to change their processes and information systems to capture information needed to apply the standard and make required disclosures.
- The standard is effective for public entities for fiscal years beginning after 15 December 2016, including interim periods within those years, and for nonpublic entities in years beginning after 15 December 2017.

Overview

Mining and metals entities may need to change certain revenue recognition practices as a result of the new revenue recognition standard jointly issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS.

The new standard provides accounting guidance for all revenue arising from contracts with customers and affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other US GAAP requirements, such as the leasing literature). The guidance also provides a model for the measurement and recognition of gains and losses on the sale of certain nonfinancial assets, such as property and equipment, including real estate.

Our Technical Line, *A closer look at the new revenue recognition standard* (SCORE No. BB2771), provides an in-depth discussion of the new revenue standard. This publication summarizes certain key implications for mining and metals entities.

Mining and metals entities also may want to monitor the discussions of the Boards' Joint Transition Resource Group for Revenue Recognition (TRG). The Boards created the TRG to help them determine whether more implementation guidance or education is needed. The TRG won't make formal recommendations to the Boards or issue guidance. Separately, the American Institute of Certified Public Accountants (AICPA) has established 16 industry task forces to help develop a new Accounting Guide on Revenue Recognition and to aid industry stakeholders in implementing the standard. The AICPA has not established a task force for the mining and metals industry. Any views discussed by the TRG or guidance produced by the AICPA is non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyze the standard and entities begin to interpret it, and our views may evolve during that process. As our understanding of the standard evolves, we will update our guidance.

Key considerations

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. They may need to use significant judgment when determining whether contracts are in the scope of the new model, evaluating the effects of various pricing terms and accounting for take-or-pay and other long-term supply arrangements.

Determining when to apply the new model

Mining and metals entities will have to first evaluate whether their contracts are subject to the new revenue standard or within the scope of other guidance, such as the leasing or financial instruments guidance (the Boards are developing a new standard on leases that could affect this assessment). Because mining and metals arrangements are increasingly complex, mining and metals entities may find it challenging to determine whether their counterparties are customers. For example, production-sharing contracts or concession agreements may be considered contracts with collaborators or partners that will not be within the scope of the standard. However, mining and metals entities may provide these counterparties with other goods and services in customer relationships that are within of the scope of the standard.

Mining and metals entities also may have contracts with repurchase provisions, which they may have to recognize as leases or financings and not as revenue. To account for these arrangements appropriately, mining and metals entities will have to carefully evaluate the repurchase requirements in the standard and the relationship between the original selling price and the repurchase price (considering the time value of money).

Mining and metals entities that dispose of assets that today are considered integral equipment or in substance real estate and that are not considered sales to customers will have to follow the new model for derecognizing nonfinancial assets (including real estate) contained in Accounting Standards Codification (ASC) 610-20, *Other Income — Gains and Losses from Derecognition of Nonfinancial Assets*.

This guidance differs significantly from current real estate sales guidance. As a result, gains on sales of these assets may be recognized sooner than they are today. The amended guidance in ASC 360-10, *Property, Plant, and Equipment — Overall*, also indicates that there may be certain circumstances in which neither ASC 606, *Revenue from Contracts with Customers*, nor ASC 610-20 will be applied when derecognizing a nonfinancial asset. The sale of a subsidiary or group of assets to a noncustomer that meets both of the following requirements will be accounted for in accordance with the derecognition guidance in ASC 810, *Consolidation:*

- It is a business.
- It is also not an in substance nonfinancial asset (because the group of assets or subsidiary also contains significant financial assets).

Refer to our Technical Line that discusses the effect of the new revenue standard on contracts in the real estate industry for more information.

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

Evaluating the effects of various pricing terms

Sales contracts for certain commodities (e.g., copper) often include provisional pricing at the time of shipment, with final pricing based on the average market price for a particular period. As they do under today's accounting, mining and metals entities will be required to separately account for embedded derivatives present in these contracts in accordance with ASC 815, *Derivatives and Hedging*. The remainder of the sales contract will be accounted for in accordance with the new standard if it is a contract with a customer. Entities will need to carefully evaluate the pricing terms to determine the transaction price. If the sales contract contains variable consideration, the entity will be required to estimate that consideration and include in the transaction price the amount for which it is probable that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved.

Entities may be required to evaluate market pricing, especially for actively traded commodities, when allocating the transaction price to performance obligations.

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

Entities that enter into multi-period contracts with terms calling for price escalations or declines in different periods (e.g., some take-or-pay contracts and long-term supply contracts) should carefully consider the contractual terms and evaluate the reasons for the price changes when identifying the performance obligations and determining how to allocate the transaction price to the performance obligations. Longer term contracts also may contain a significant financing component that entities will have to account for separately.

Properly identifying the performance obligations in contracts involving commodities (e.g., selling, refining) will be critical. If a mining and metals entity determines that a fixed-price contract to sell a commodity over multiple periods has multiple performance obligations, the entity will need to determine the standalone selling price of each performance obligation in order to allocate the transaction price and ultimately establish the pattern of revenue recognition. The new standard does not specify how to determine the selling price for sales of commodities that are determined to be multiple performance obligations (e.g., use a calculated value, a current market price or a forward price). As a result, additional developments in this area are likely.

Bill-and-hold agreements

Mining and metals entities may have transactions in which they hold product on behalf of the customer due to customer storage constraints or for other reasons. The new guidance on bill-and-hold arrangements is less specific than today's guidance and doesn't include certain criteria, such as today's requirement for a fixed delivery schedule. We expect bill-and-hold transactions that qualify as revenue under today's guidance to also qualify as revenue under the new standard. An entity that meets the revised bill-and-hold criteria will have to consider whether it has a separate performance obligation under the arrangement to provide custodial and security services during the holding period.

Next steps

- Entities should perform a preliminary assessment on how they will be affected as soon as possible so they can determine how to prepare to implement the new standard. While the effect on entities will vary, entities may face significant changes in revenue recognition. All entities will need to evaluate the requirements of the new standard and make sure they have processes and systems in place to collect the necessary information to implement the standard, even if their accounting results won't change significantly or at all.

- Entities also may want to monitor the discussions of the Boards, the Securities and Exchange Commission (SEC) staff and the TRG to discuss interpretations and application of the new standard to common transactions.

- Public entities also should consider how they will communicate the changes with investors and other stakeholders, including their plan for disclosures about the effects of new accounting standards discussed in SEC Staff Accounting Bulletin (SAB) Topic 11.M. The SEC staff has indicated it expects an entity's disclosures to evolve in each reporting period as more information about the effects of the new standard becomes available, and the entity should disclose its transition method once it selects it.

EY | Assurance | Tax | Transactions | Advisory

© 2014 Ernst & Young LLP.
All Rights Reserved.

SCORE No. BB2816

ey.com/us/accountinglink

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.