ShineWing AUSTRALIA

ALERT

IFRS 15 Revenue recognition under mineral streaming agreements

IFRS 15 Revenue from Contracts with Customers became applicable from 1 January 2018.

There are many different types of contracts with customers that require a detailed analysis in order to determine the appropriate accounting treatment under IFRS 15. For the energy and resources industry, one such contract is a streaming agreement. This article looks at streaming agreements and the issues to consider in applying IFRS 15.

What is a streaming agreement?

A streaming agreement is an alternative financing method whereby a mining company promises to share future production from its specific mining properties in exchange for an upfront payment from the buyer. The mining company uses the funds as capital to explore and develop its prospective mine. The agreement also includes a sale price on future deliveries that is usually pre-determined at a lower rate than market price and recovered against the upfront payment. After the upfront payment has been exhausted, the buyer usually continues to make separate payments for further deliveries.

Other terms that may be included in streaming agreements include:

- Increasing the sale price over the term of the agreement
- Adding an interest component to the upfront payment
- The sale price is stated as the lesser of the market price and a specified price.

Issues to consider

- **Is it a lease arrangement?**

  Before applying IFRS 15, there needs to be an assessment of whether there is a lease arrangement ie whether the buyer is allowed to gain substantially all of the economic benefits from the asset, with a right to direct the use of the asset during the entire term of contract. This requires careful analysis of the terms of the contract to assess the extent of control the buyer has over the mining assets.

- **Determining whether the contract is within the scope of IFRS 15 – is the counterparty a customer?**

  Since the funds provided for by the buyer are being used for exploration and development of the mine, the buyer effectively participates in the mining activity through this financial support. If subsequently the share of production and price risks is assessed to be significant to the buyer it could be interpreted as a collaboration arrangement outside the scope of IFRS 15. This judgment can be made only after a careful assessment of the contract. However the contract may still have elements of a 'contract with customer' to the extent of performance obligations (i.e. transfer of distinct goods or service) that may be required to be satisfied. Thus the entity needs to separate the components that are within the scope of IFRS 15 from those that are not and recognise them separately. Those not within the scope of IFRS 15 are recognised under the applicable IFRS. One component that may require separate accounting is an embedded derivative, depending on the sale price formula in the agreement.

- **Identification of performance obligations**

  IFRS 15 requires that the entity identifies performance obligations at the inception of the contract. In a streaming agreement though, this would be difficult since the entity does not yet know how much it can deliver. However this may not be the case if the production volume to be supplied in future is fixed and the contract provides for supplying the shortfall quantity from other mines of the seller. It is a requirement that the goods should be distinct so as to be determined as a performance obligation. There is no explicit guidance from the standard whether the goods can be regarded as 'distinct' if their quantities are not known at the inception of the contract, although it will be known only after a substantial period of time. Such challenges also pose difficulties in making reasonably accurate disclosures in the financial statements regarding the contract with that customer such as transaction price (due to high amount of variability) and amounts allocated to performance obligations.

- **Accounting treatment of the upfront payment**

  The upfront payment received from the buyer is utilised for mine exploration and development activities. A portion of it may also be utilised to offset the sale price payable on future deliveries once the preparatory phase has been completed. The entity needs to exercise judgment as to whether to exclude that portion of the upfront payment that represents a prepayment for the future transfer of goods. The portion used for mine exploration and development may be regarded as tasks undertaken to fulfil the order and not transferring any goods to the buyer. Hence the entity cannot recognise the entire amount as a contract liability. It would be difficult at the inception of the contract to estimate what portion relates to performance obligations and what relates to a financial obligation. Any amount that relates to a financial obligation must be separately accounted for under *IFRS 9 Financial Instruments.*

  For any amount that relates to a prepayment for the future transfer of goods, IFRS 15 requires consideration of whether there is a significant financing component, which is required to be accounted for separately from revenue. Where the interest component is already explicitly identified in the agreement, this should be accounted for separately from revenue as interest income.

Let's discuss the possibilities.

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