

Solution 3.2.

Component: Revenues (IAS 18)

Short title: Sales to metals exchanges

Issue

Metals companies involved in the production of traded metals (aluminium, copper, nickel, lead, tin, zinc, etc.) often sell metal to metal exchanges, such as the London Metals Exchange. A supplier may deliver metal to a warehouse authorised by the metal exchange and receives a warrant – a bearer document of title enabling the holder to take possession of a specified "load" of metal at a specified approved warehouse. The supplier buys a futures contract from the metal exchange at the same point. Metal will be supplied to the warehouse at a particular price on a particular date by the supplier. The supplier settles its obligation by means of the warrant. The metal exchange transfers cash for the metal to the supplier or a designated broker on presentation of the warrant.

When should revenue from sales of metal shipped to metal exchanges be recognised?

Solution

Revenue from the sale of goods is recognised when all the following conditions have been satisfied:

- a) the reporting entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
- b) the reporting entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- c) the amount of revenue can be measured reliably;
- d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
- e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Conceptually, there are at least two possible dates when revenue might be recognised:

1. when the supplier delivers inventory to a warehouse and gets a warrant in exchange;
2. when the supplier transfers the warrant to the metal exchange.

The table below illustrates whether these revenue recognition criteria are satisfied at each of these points in a typical arrangement.

Recognition criteria per IAS 18.14	Point 1	Point 2
a)	No	Yes
b)	No	Yes
c)	No	Yes
d)	No	Yes
e)	Yes	Yes

Revenue can be recognised after the supplier transfers the warrant to the metals exchange.

There is no basis for revenue recognition at point 1. The supplier has in substance changed the location of its inventories, without transferring the significant risks and rewards of ownership of the metal. Under the terms of the agreement with the warehouse the risk of loss of inventory due to improper storage conditions may often transfer to the warehouse, but the rewards of ownership of the goods and title remain with the supplier.

Revenue should be recognised at the point when the supplier transfers the warrant to the metal exchange. All conditions above on the transfer of ownership and economic certainty will have been satisfied. The warrant, by definition, is a document that confirms bearer title for the metal held in an approved warehouse. Once a warrant is transferred to another party, a new holder is entitled to the ownership of the metal and assumes the significant risks and rewards related to the ownership of the metal.