Gemfields Inventory Accounting

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An illustrative guide

Responsibly sourced Zambian emeralds and Mozambican rubies.

Championing transparency and trust in the coloured gemstone industry.

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Overview

Gemfields gemstone inventory accounting

The following presentation sets out the theory behind how Gemfields Group Limited ('Gemfields') and its subsidiaries account for rough gemstone inventory. It includes a worked example in which dummy numbers have been used.

In accordance with International Financial Reporting Standards (IAS 2) inventory is required to be measured at the lower of cost and net realisable value (estimated market value based on past auctions). Various cost methods are available and can be used such as specific identification, weighted average or first-in first-out (FIFO).

Gemfields, like many other mining companies, uses the weighted average cost of production whereby the directly attributable production costs are capitalised and held on the balance sheet as inventory. Therefore all gemstone carats held at any one time are given the same cost price. It is this price which is used when calculating the 'cost of sales' and therefore the gross profit.

Gemfields' gemstone inventory consists primarily of emerald and beryl from the Kagem emerald mine in Zambia and ruby and corundum from the Montepuez ruby mine in Mozambique. The production process for both emeralds and rubies involves mining, washing & clipping (processing), and sorting & grading.

Gemfields has determined directly attributable production costs to be:

- mining and production labour;
- fuel;
- blasting costs including explosives;
- certain security costs;
- camp costs associated with housing and feeding employees;
- depreciation;
- repairs & maintenance; and
- processing costs.

These directly attributable costs are capitalised to the cost of inventory as 'capitalised costs'.

Please note that mineral royalties and production taxes are not included in the cost of inventory. Please also note that beryl and corundum are considered as by-products and as such are valued at their net realisable value.

Transaction overview and illustrative example

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The transaction process is discussed below

1. Mining and Production:

- On a monthly basis, the production costs (as defined on the previous slide) are capitalised to inventory on the balance sheet ('capitalised costs').
- The capitalised costs are averaged across the gemstone inventory with all carats irrespective of grade valued at the same price. In theory it costs the same to mine a premium carat as it does a lower grade.
- In the general ledger this is achieved by firstly accounting for each category of production cost in the normal way and then crediting these costs against the inventory on the balance sheet. These accounting entries are set out on the next page:

  Journal 1(a) Recognise the individual costs by line item and the supplier account.

  Journal 1(b) Recognise the inventory on the balance sheet at the end of the month.

Illustrative example

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Capitalisation of monthly production costs

	January	February	March	April	May	June	Total
1. Monthly production costs are capitalised							
Mining cost per month (USD)	2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**
Production in the month (carats)	1,500,000	1,000,000	700,000	2,000,000	1,200,000	2,800,000	**9,200,000**
Cost per carat (USD)	1.33	1.40	1.81	1.50	1.61	1.28	1.28
(a) Recognise the individual costs by line item and the supplier account.							
DR: Labour costs	720,000	720,000	720,000	720,000	900,000	720,000	**4,500,000**
Fuel cost	450,000	300,000	625,000	450,000	650,000	300,000	**2,775,000**
Blasting costs	110,000	80,000	130,000	110,000	160,000	80,000	**670,000**
Camp costs	205,000	200,000	205,000	205,000	205,000	200,000	**1,220,000**
Repairs & maintenance	350,000	120,000	450,000	350,000	420,000	120,000	**1,810,000**
Processing costs	95,000	50,000	100,000	95,000	95,000	50,000	**485,000**
Other	70,000	30,000	70,000	70,000	70,000	30,000	**340,000**
CR: Accounts payable	2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**
(b) Recognise the inventory on the balance sheet at the end of the month							
DR: Inventory	2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**
CR: Change in inventory - capiatlised costs in the income statement	2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**
Net journal reflects the fact that the inventory produced in unsold							
DR: Inventory - balance sheet	2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**
CR: Accounts payable/ Fixed assets - balance sheet	2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**

This process within the general ledger allows the correct accounting for payroll, specific invoices and issues from consumable stores all costs that are used in the production process and therefore included in the inventory balance.

Transaction overview and illustrative example

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The transaction process is discussed below

2. Sales and cost of sales:

- On sale of the gemstones, the revenue is recognised at the final winning bid.
- The cost of sales brings the cost of producing these carats through the income statement by taking the weighted average production cost and multiplying that by the number of carats sold.
- The accounting entries are illustrated below:

Journal 2 (a) Recognise the sale at the winning bid and invoice price.

Journal 2 (b) Recognise the cost of goods sold by reducing inventory for the cost of the carats sold.

	January	February	March	April	May	June	Total
2. Sale of gemstones at an auction - recognise the sale and the cost of sale							
Invoiced value of carats sold at auction = revenue			25,000,000			15,000,000	**40,000,000**
Cost of the carats sold = cost of sales			(1,800,000)			(14,230,769)	**(16,030,769)**
Auction sales (carats)			(1,000,000)			(8,000,000)	**(9,000,000)**
(a) Recognise the sale at the winning bid and invoice price							
DR: Accounts receivables - balance sheet			25,000,000			15,000,000	**40,000,000**
CR: Revenue			25,000,000			15,000,000	**40,000,000**
(b) Recognise the cost of goods sold by reducing inventory for the cost of the carats sold.							
DR: Cost of goods sold - income statement			(1,800,000)			(14,230,769)	**(16,030,769)**
CR: Inventory			(1,800,000)			(14,230,769)	**(16,030,769)**

Calculated as carats sold x weighted average cost of inventory i.e. 1,800,000 carats x 1.80 USD/carat

Transaction overview and illustrative example

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The transaction process is discussed below

3. Net impact

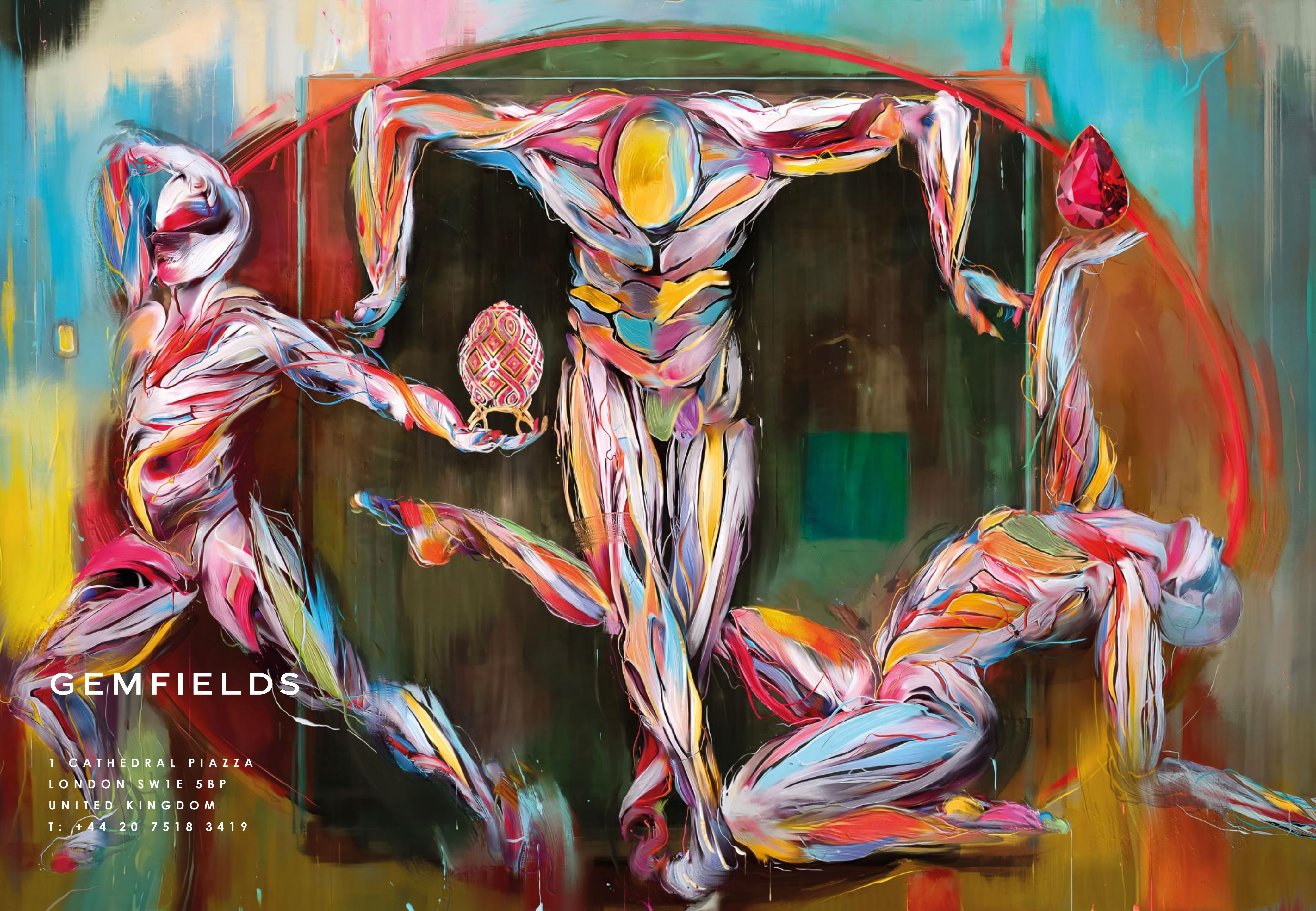
- On a monthly basis, unless there is an auction, the capitalised cost of production will be the only number seen going through the accounts in relation to inventory.
- Over a year, or a period including an auction, Gemfields nets off the capitalised costs of production for that period against the cost of sales of the gemstones sold.
- The make-up of the inventory balance is illustrated below which shows the inventory build up by the monthly capitalised costs and the subsequent reduction for carats sold. The weighted average production cost calculation is also illustrated here.

	Opening	January	February	March	April	May	June	Total
3. Inventory held on balance sheet								
Carrying value USD	10,000,000	12,000,000	13,500,000	14,000,000	16,000,000	18,500,000	5,769,231	**5,769,231**
Carats	5,000,000	6,500,000	7,500,000	7,200,000	9,200,000	10,400,000	5,200,000	**5,200,000**
Weighted average per carat	*2.00*	*1.85*	*1.80*	*1.94*	*1.74*	*1.78*	*1.11*	***1.11***
								1.11
Change in inventory	-	2,000,000	1,500,000	500,000	2,000,000	2,500,000	(12,730,769)	**(4,230,769)**
Financial statement presentation								
Revenue				25,000,000			15,000,000	**40,000,000**
Cost of sales				(1,800,000)			(14,230,769)	**(16,030,769)**
Capitalised costs		2,000,000	1,500,000	2,300,000	2,000,000	2,500,000	1,500,000	**11,800,000**
Change in inventory (movement in the income statement)		2,000,000	1,500,000	500,000	2,000,000	2,500,000	(12,730,769)	**(4,230,769)**

Cost per carat of inventory held is used to determine the cost of sales and the consequent reduction of inventory.

These costs are itemised by category in the notes to the financial statements as a result of the journal 1 (a) above.

As can be seen from other mining entities, to provide sufficient useful information the capitalised costs are broken down by cost category such as labour, fuel, blasting etc. Refer to note 4 of the 2019 Annual Report and Accounts.



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1 CATHEDRAL PIAZZA
LONDON SW1E 5BP
UNITED KINGDOM
T: +44 20 7518 3419