No. 2014-22
26 August 2014

Technical Line

FASB — final guidance

The new revenue recognition standard — oil and gas

Upstream entities will continue to follow existing guidance to account for conveyances of oil and gas mineral rights.

What you need to know

- The new revenue recognition standard is more principles-based than current guidance and will require oil and gas entities to exercise more judgment.
- The key issues for the industry will be appropriately identifying the performance obligations in the contract and allocating the transaction price to those performance obligations, which will affect how revenue is recognized.
- Oil and gas entities may have to change their processes and information systems to capture information they will need 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

Oil and gas 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 (the FASB) and the International Accounting Standards Board (the IASB) (collectively, the Boards). The new revenue recognition standard will supersede virtually all revenue recognition guidance in US GAAP and IFRS, including certain transaction-specific guidance that oil and gas entities use today.

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

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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 high-level implications for oil and gas entities.

Oil and gas entities also may want to monitor the discussions of both the Boards' Joint Transition Resource Group for Revenue Recognition (TRG) and a task force formed by the American Institute of Certified Public Accountants (AICPA) to focus on oil and gas issues. 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. The AICPA's oil and gas industry task force is one of 16 industry task forces the AICPA has formed to help develop a new Accounting Guide on Revenue Recognition and to aid industry stakeholders in implementing the standard. 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.

Longer term contracts also may contain a significant financing component that will need to be accounted for separately.

Key considerations

To apply the new standard, entities in all sectors of the oil and gas industry will need to change the way they evaluate many of their transactions, even if the amounts they report are not expected to change significantly. Oil and gas entities will need to apply significant judgment when they evaluate contracts with customers including those involving commodities, multi-period contracts and sales of nonfinancial assets.

Properly identifying the performance obligations in contracts involving commodities (e.g., selling, transporting, processing) will be critical. If an oil and gas 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 provide specifics for determining the selling price for contracts to sell commodities that involve 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.

Entities across all subsectors that enter into multi-period contracts to sell goods or services with terms calling for price escalations or declines in different periods (e.g., some take-or-pay contracts, provisionally priced contracts, minimum capacity contracts, 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.

Oil and gas entities that dispose of assets that today are considered integral equipment or in substance real estate (other than conveyances of oil and gas interests discussed below) and those disposals 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 are applied when derecognizing a nonfinancial asset. The sale of a subsidiary or group of assets that meets both of the following requirements is accounted for in accordance with the derecognition guidance in ASC 810, *Consolidation:*

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

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

Upstream considerations

One key question for upstream entities that use the entitlements method to account for production imbalances is whether the Securities and Exchange Commission (SEC) staff will rescind, amend or retain its guidance allowing the use of this method. The sales method that some entities use to account for these imbalances appears to be more consistent with the new standard, but the SEC staff hasn't yet said whether or how it will change its guidance in light of the new standard.

Drilling, logistics and other entities will have to first evaluate whether contracts follow revenue or leasing guidance, which could change as a result of the Boards' joint project on leases.

Certain contracts that upstream entities commonly enter into will remain outside the scope of the new standard. For example, they will continue to follow existing guidance to account for conveyances of oil and gas interests. Because most production sharing, joint venture and similar arrangements are contracts with collaborators or partners, not contracts with customers, they also are outside the scope of the new standard. However, upstream entities may provide other goods and services to these counterparties as customers.

Midstream considerations

Midstream entities will need to evaluate whether the various services they provide, such as gathering and processing and providing other services like compression, are separate performance obligations. Gathering entities may need to evaluate whether promises to construct and transfer well connections to a customer as part of a gathering agreement are separate performance obligations. An entity that instead considers the well connections costs to fulfill a contract will likely include any cost-based reimbursements from the customer or other payments received in the transaction price and allocate it to the performance obligations (e.g., the gathering services).

Pipeline transportation and storage entities will need to consider whether their arrangements fall within the scope of leasing guidance before applying the new revenue standard. The new revenue standard also will not apply to alternative revenue programs for rate-regulated entities, which generally aren't considered contracts with customers because of the involvement of regulators.

Downstream considerations

The new guidance requires the application of significant judgment in determining the appropriate accounting for downstream entities' brand licensing arrangements (which contain licenses of intellectual property), including sales-based royalty arrangements. We believe this complexity may lead to interpretive questions. The TRG has discussed certain licensing issues, but it's unclear whether the Boards will take action. Downstream entities with these types of arrangements should monitor activity in this area.

Oil and gas retailers should consider issues affecting retailers more broadly, as discussed in our Technical Line, *The new revenue recognition standard — retail and consumer products* (SCORE No. BB2806).

Oil field services (OFS) considerations

Drillers and other entities will need to first evaluate whether their contracts fall within the scope of revenue or leasing guidance, which could also change as a result of the Boards' separate project on accounting for leases. For contracts (or services within contracts) in the scope of the revenue standard, drillers will need to evaluate each of the activities (e.g., drilling, mobilization, standby activities) to identify the performance obligations and the pattern of revenue recognition. They may determine that all drilling-related services are a single performance obligation satisfied over the entire drilling contract term. Alternatively, they may determine that they have multiple performance obligations that they satisfy at a point in time or over time, depending on the nature of the activities. In identifying performance obligations, an entity could reach different conclusions than it does today about units of account, resulting in a different pattern of revenue recognition. Drillers also must evaluate how to account for up-front mobilization costs and related reimbursements.

Entities that license seismic data libraries may have to apply the guidance for licensing intellectual property if they determine that a license is distinct (i.e., the customer can benefit from the license on its own or with other readily available resources, and the license is separately identifiable from other contract promises). The new standard requires significant judgment to analyze the facts and circumstances for these arrangements, which may raise interpretive questions. Seismic entities with these types of contacts should refer to our Technical Line, *The new revenue recognition standard — software and cloud services* (SCORE No. BB2805). The TRG has discussed certain licensing issues, but it's unclear how the Boards will respond. Seismic entities should monitor developments.

OFS entities also should consider our publications on related industries and monitor implementation efforts by those industries. For example, OFS entities that provide engineering and construction services should look for our upcoming Technical Line that will discuss the effect of the new revenue standard on engineering and construction contracts.

Next steps

- Oil and gas 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 SEC staff, the TRG and the oil and gas and other industry task forces formed by the AICPA 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 expects entities' disclosures to evolve in each reporting period as more information becomes available.