

San Antonio Petroleum Accountants Society

DEALING WITH AUDITORS

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Disclaimer

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Agenda

- 1) Auditing the Work of a Specialist
- 2) Auditing Impairment Calculation and
- 3) New Revenue Recognition Issues for E&P Companies



Auditing the Work of a Specialist

RESERVOIR ENGINEER
(RESERVE REPORT)



Why Audit the work of a Reservoir Engineer

AU Section 336

Evaluate Professional Qualifications

Understand the Nature of the Work Performed

Objectives

Specialist's Relationship to Client

Assumptions

Look Back

Evaluate Specialist's Content and Findings



Professional Qualifications

Reputation of Firm

Resume of Individual Engineer

Understand the Nature of the Work Performed

Auditor's document the reason for the reserve study and how it impacts the financial statement captions

Depletion

Impairment

Specialist's Relationship to Client

Independent or Related Party (employee, affiliate, etc.)



ASSUMPTIONS

Inputs to the reserve information varies and includes

Historical Production Data for Producing Wells

Historical and Projected Costs

Investment

Lease Operating Costs

Taxes

Price

Historical Price (Depletion and Full Cost)

Impairment (Future Strip Price)

LOOKBACK

DID ACTUAL RESULTS
COMPARE TO PRIOR YEARS
RESERVE ESTIMATES

Evaluate Specialist's Content and Findings

TESTING CLERICAL AND
MATHEMATICAL ACCURACY

Auditing Impairment Calculation

WHAT AUDITORS LOOK FOR

Oil and Gas Properties

- 1) SUCCESSFUL EFFORTS
COMPANIES ONLY
- 2) IMPAIRMENT TESTING
REQUIRED WHENEVER
THERE IS A CONCERN
ABOUT RECOVERABILITY

Impairment

WHEN UNDISCOUNTED CASH
FLOW AT EXPECTED PRICE IS
LESS THAN BOOK VALUE OF
RESERVES

Audit Issues

- 1) PRICING
- 2) WHAT LEVEL IS IMPAIRMENT BEING APPLIED (WELL, FIELD, ETC)
- 3) AMOUNT OF WRITEDOWN (FAIR VALUE)

Audit Issues

- 4) PROVED, PROBABLE AND POSSIBLE RESERVES

Revenue Recognition for E&P Companies under ASC606

WHAT TO EXPECT

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- 1) Sales of Oil and Gas
 - a) Gross vs Net Reporting
 - b) Gas Imbalance
 - c) Volume sold Estimates

 - 2) Purchases and Sales of Inventory with the same Counterparty

 - 3) Revenue Recognition for Collaborative Arrangements and JOA's

 - 4) Derivative Commodity Contracts

 - 5) Disclosures

Revenue recognition principle:

Current: Recognize revenue when it is earned and realizable.

New: Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Sales of Oil and Gas

- Revenue from sales of oil and gas (that are not accounted for as derivatives under ASC 815) should be recognized when control of the oil and gas transfers to the customers.
- Recorded at transaction price, which is the \$ entity expects to be entitled to and may be net of \$ paid for oil and gas sold on behalf of others (including royalties), discounts, and allowances.
- Various taxes (sales, use, excise, and value added) should be evaluated whether \$ are imposed on oil and gas entities and passed on to customers, or imposed on customers and collected by oil and gas entities.
- Principal vs Agent – “a performance obligation to provide the specified goods or services” or “to arrange for those goods and services to be provided by other party”. – Does the entity has control of the goods or services before it is transferred to customers.
- Both operators and non-operators are required to evaluate.

Sales of Oil and Gas (continued)

- Gas imbalance is generally outside the scope of ASC 606
- Entities should record revenue based on an estimate of the volumes delivered

Purchases and sales of Inventory with the Same Counterparty

- Viewed as a single transaction if P & S were entered into contemplation of one another
- Finished goods for raw material/ work-in-process – nonmonetary exchange, fair value. If the transaction is with a customer, the entity should follow ASC 606.
- Raw material/ work-in-process for raw material/ work-in-process – nonmonetary exchange, carrying value. Outside of ASC 606

Collaborative Arrangements and Joint Operating Agreements

- LOEs reimbursements, COPAS overhead reimbursements, etc.
- Generally, the WI owners do not meet the definition of a customer – not subject to 606
- In some case, an operator may provide services (gathering) for other JO interest owners – may be considered customers and will follow ASC 606

Derivative Commodity Contracts

- If a contract will not be settled net and will result in physical delivery, the contract may be accounted for as a normal purchase/ normal sales and follow ASC 606

Disclosures

- Separate disclosure of revenue/ receivable from contracts with customers subject to ASC 606 and from other sources
- Disaggregation of revenue by type
- Disclose revenue recognized in current period from performance obligations satisfied in previous periods