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IFRS Developments for Oil & Gas – Oilfield Services

The new revenue recognition standard – oilfield services

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What you need to know

- The application of IFRS 15 will require entities to use a greater degree of judgement to meet its requirements.
- The key issues for oilfield services entities include:
  - Identifying whether a contract is within the scope of the new standard
  - Evaluating performance obligations in contracts, which will affect how revenue is recognised
  - Assessing the impact of variable consideration within a contract.
- Oilfield services entities may have to change their processes and information systems to capture information they will need to apply the standard and make the required disclosures.
- The standard is applicable for annual reporting periods commencing on or after 1 January 2017, with early adoption permitted.

Highlights

Oilfield services (OFS) entities may need to change certain revenue recognition practices as a result of IFRS 15 *Revenue from Contracts with Customers*, the new revenue recognition standard that was jointly issued by the International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (the FASB) (collectively, the Boards). The standard will supersede virtually all revenue recognition requirements in IFRS and US GAAP.

IFRS 15 provides accounting requirements 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 IFRS requirements, such as IAS 17 *Leases*). The standard also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant and equipment (PP&E).

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Our *Applying IFRS*: *A closer look at the new revenue recognition standard*[1] provides an in-depth discussion of IFRS 15, whereas this publication summarises the key implications of the standard for OFS entities.

OFS entities may want to monitor the discussions of the Boards' Joint Transition Resource Group for Revenue Recognition (TRG). The TRG was created to help the Boards determine whether more implementation guidance is needed. The TRG will not make formal recommendations to the Boards or issue guidance. Any views discussed by the TRG will be non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyse the standard and entities begin to interpret it, and our views may evolve during that process.

Key considerations

OFS cover a wide range of value chain segments, from reservoir, seismic and data processing, to drilling, operations (production and maintenance) and decommissioning. The larger OFS entities often provide a wide range of services across the value chain, offering integrated solutions to customers. Smaller entities typically focus on providing more specific products and services. Therefore, the nature and complexity of the contractual arrangements with customers that may arise within OFS is varied.

We anticipate that the implementation of IFRS 15 will impact OFS entities to varying degrees depending on the complexity of the contractual arrangements entered into. Therefore, OFS entities will need to change the way they evaluate many of their transactions, and their financial reporting processes overall.

OFS entities may need to use judgement to evaluate whether contracts fall within the scope of IFRS 15 and determine the individual performance obligations within a contract.

Identifying when to apply IFRS 15

OFS entities that provide drilling, logistics or other services must first evaluate whether their contracts fall within the scope of IFRS 15, or if they are within the scope of other IFRSs, such as IAS 17. A contract entered into for the hire of a drilling rig or equipment may represent an arrangement that contains a lease, and would be subject to the leases standard. This assessment could change in the future as a result of the Boards' joint project on leases.

Drilling, logistics and other OFS entities must first evaluate whether contracts follow the revenue or leases standards, which could change as a result of the Boards' joint project on leases.

OFS entities may dispose of non-financial assets such as PP&E. IFRS 15 consequentially amends other standards, such as IAS 16 *Property, Plant and Equipment*, and will effectively establish a new model for derecognising non-financial assets that applies its concepts, even for sales to non-customers. As a result, the measurement and timing of recognition of gains/losses on sales of these assets may differ from that under current IFRS.

Evaluating performance obligations in contracts with multiple elements

For contracts that fall under IFRS 15, drillers, in particular, will need to evaluate each of the activities (e.g., drilling, mobilisation and demobilisation, 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 recognised at a point in time or over time, depending on the nature of the underlying activities. In identifying performance obligations, an entity could reach different conclusions than it does today, resulting in a different pattern of revenue recognition. In particular, drillers must evaluate how to account for upfront mobilisation costs and related reimbursements.

[1] Available on www.ey.com/ifrs

Assessing the impact of contractual cash flows on revenue recognition

OFS contracts are often multi-period contracts for the supply of equipment and contract terms often allow for incentives, bonuses, penalties, contingencies or credits. These contractual terms generally introduce a variable element to the contract consideration, which should be carefully considered when determining how to allocate the transaction price to the individual performance obligations identified.

Variable consideration can be calculated using one of two methods, the expected value or the most likely amount. The method that best predicts the consideration to which the entity is entitled must be used, and must be applied consistently throughout the contract and across similar contracts. Variable consideration is recognised only if it is highly probable that a reversal will not occur, and the estimate of amounts to be recorded should be updated each reporting date. As a result, conclusions reached regarding variable consideration may change the pattern of revenue recognised.

Accounting for seismic licences

Entities that license seismic data libraries may have to apply the requirements for licences of intellectual property if they determine the licence is distinct (i.e., the customer can benefit from the licence on its own or with other readily available resources, and the licence is separately identifiable from other contract promises). IFRS 15 requires significant judgement to analyse the facts and circumstances for these arrangements, which may raise interpretive questions. The TRG has discussed certain licensing issues. However, it is unclear how the Boards will respond. Seismic entities should monitor the developments on these discussions.

Next steps

OFS entities will need to evaluate the requirements of IFRS 15 and ensure they have processes and systems in place to collect the necessary information to implement the standard. They may also wish to monitor the ongoing discussions of the Boards and TRG so they can consider the impact of evolving interpretations and application of the new standard to common transactions. Entities also should consider their communication plans with investors and other stakeholders, including their plan for disclosure of the effects of new accounting standards that are issued but not yet effective, as required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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