Accounting/SEC Update

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Agenda

- SEC headlines
- Leases
- Credit losses
- Definition of a business
- Critical audit matters
- Effective dates of new standards

SEC headlines

Final rules

SEC amends Regulation S-K

- Allows registrants to omit confidential information from most exhibits without filing a confidential treatment request.
- Allows for flexibility in discussing historical periods in Management's Discussion and Analysis.

Amendments	Effective date
Redaction of confidential information in material contracts exhibits	April 2, 2019
iXBRL tagging of cover page data for certain filings	Subject to a three-year phase-in, depending on the registrant's filing status.
Certain investment company filings in HTML format with hyperlinks	For registration statements and Form N-CSR filings made on or after April 1, 2020. Early adoption is permitted.
All other amendments	May 2, 2019

Proposed rules

Amended disclosure requirements for business acquisitions and dispositions

- Intended to improve the information that investors receive about business acquisitions and disposals.
- The SEC also is proposing a new rule to govern financial reporting for acquisitions involving investment companies and real estate operations.

New definitions of ‘accelerated’ and ‘large accelerated’ filers

The proposed rule would:

- revise the definitions to exclude issuers that are (1) eligible to be a smaller reporting company (SRC) and (2) have < $100 million in annual revenues;
- increase transition thresholds to (1) exit large accelerated filer status and (2) become a non-accelerated filer;
- add a revenue test; and
- exempt SRCs with < $100 million in revenues from complying with internal control rules.

Comment periods end July 29

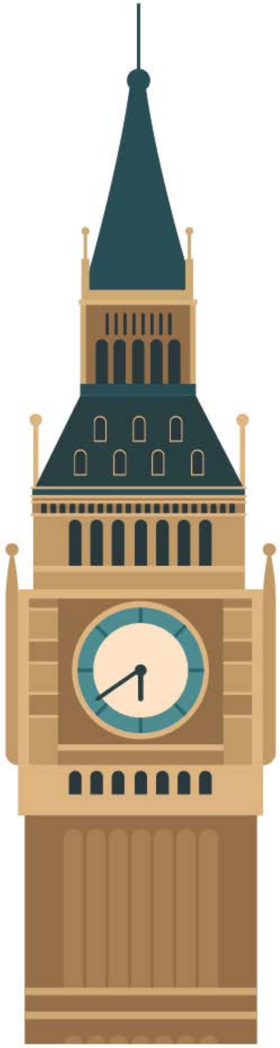
Disclosure considerations

Brexit

- The deadline for the UK's withdrawal from the EU has been extended to October 31, 2019.
- The SEC staff is closely monitoring how registrants disclose the effect that Brexit may have on their business operations.
- Registrants should monitor Brexit developments for changes that may require them to revise risk factors in their 2019 quarterly reports.

LIBOR

- Banks that currently report information used to set LIBOR are expected to stop doing so after 2021.
- Issuers may face risks and uncertainties in managing the transition from LIBOR to a new rate.
- The SEC staff expects to see disclosures addressing these risks and uncertainties.



Frequent areas of SEC staff comment

Comment letter topic	Ranking 2018	Ranking 2017
Management's discussion & analysis	1	2
Non-GAAP financial measures	2	1
Revenue recognition	3	4
Fair value measurements	4	3
State sponsors of terrorism	5	9
Intangible assets	6	6
Acquisitions and business combinations	7	7
Income taxes	8	8
Segment reporting	9	5
Signatures and exhibits	10	10

Source: Audit Analytics – Comment letter taxonomy for SEC staff comment letters issued to registrants related to Forms 10-K, 10-Q and 8-K for the twelve months ended December 31, 2018 and 2017

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Leases

Leases, where are we now?

ASU 2016-02 Issued
February 2016

Beginning of earliest period presented
January 1, 2017

SAB 74 Disclosures

January 1, 2018

Effective Date (date of adoption)
January 1, 2019

First application date if ASU 2018-11 transition option is elected

We are here today

Comparative Periods

Current Period

December 31, 2019

- **Public entities**: effective for annual and interim periods in fiscal years beginning after 12/15/2018
- **All other entities**: effective for annual periods in fiscal years beginning after 12/15/2019, and interim periods in fiscal years beginning after 12/15/2020
- **Proposed deferral for all other entities:** On 7/17/2019 the FASB Board voted to propose an ASU that would defer adoption for non-public entities by 1 year

Presentation clarifications

Presentation in the statement of cash flows

Background

— ASC 842 requires lessees to classify operating lease payments as cash outflows from operating activities, but it does not address how to reconcile lease expense to lease payments in the reconciliation of net income to net cash flows from operating activities.

Clarification

— (1) Present separately the amortization of right of use (ROU) asset and the change in the operating lease liability in the reconciliation of net income to net cash flows from operating activities, **or**

— (2) Present the combined information in the same line item in the reconciliation.

— The presentation approach must be disclosed and applied consistently.

Presentation clarifications

Presenting new lease-related deferred tax assets and liabilities

Background

— On adopting ASC 842, lessees will recognize significant new deferred tax assets and deferred tax liabilities arising from the newly-recognized right of use (ROU) assets and lease liabilities for ASC 840 operating leases.

Clarification

— Lessees should present new deferred tax assets and liabilities net for each tax jurisdiction on the balance sheet.

— Must be presented gross in the income tax disclosures.

Lease term refresher

Noncancellable period
(including any rent free periods)

+

Optional renewal periods if lessee is ***reasonably certain*** to exercise

+

Periods after optional termination date if lessee ***reasonably certain <u>not</u>*** to exercise optional termination

+

Optional periods to extend (or not to terminate) the lease in which exercise of option is controlled by the ***lessor***

=

Lease Term

Comparison to ASC 840

Determination of lease term under ASC 842 will remain substantially unchanged from ASC 840.

Timing of assessment

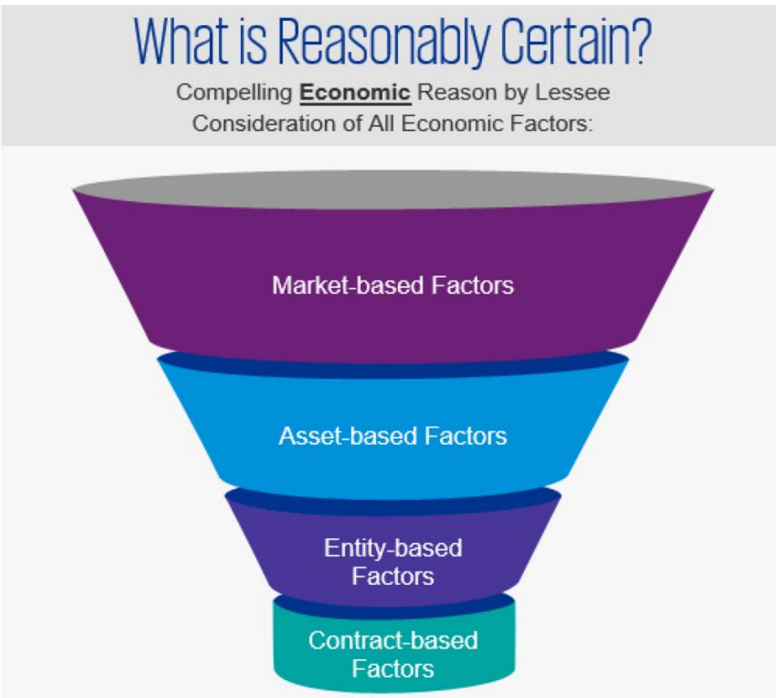
Lease term is assessed at lease commencement.

Factors to consider

Consider all *economic* factors relevant to the assessment.

Penalty vs. reasonable certain

Reasonably certain – a high threshold of probability that considers all economic factors relevant to the assessment.



Penalty *– Any requirement that is or can be imposed by the lease agreement or factors outside the lease agreement to do any of the following:*

- **Pay cash**
- **Incur or assume liability**
- **Perform services**
- **Transfer an asset**
- **Forego an economic benefit**
- **Suffer an economic detriment**

Evergreen agreement – Lease term example

Scenario:

Upstream Lessee (LE) and Compressor Lessor (LR) enter into a lease, granting LE the right to use LR's compressor for a **non-cancellable period** of <u>nine months</u>.

After nine months, the lease will **continue on a month to month basis** unless cancelled by either party. Lease payments are fixed ($2,000 per month) and considered at-market.

Each party has the **unilateral right to terminate** the lease by providing 30 days notice to the other party. If LE terminates the contract, LE will incur $3,400 in non-recurring costs:

- $2,000 to transport the compressor back to LR's location
- $1,400 to install the replacement of the compressor
- Other amounts assumed to be inconsequential (downtime of well)

Lease term analysis:

Non-cancellable period	+	Optional renewal periods if lessee is ***reasonably certain*** to exercise	+	Periods after optional termination date if lessee ***reasonably certain*** ***<u>not</u>*** to exercise optional termination	+	Optional periods to extend (or not to terminate) the lease in which exercise of option is controlled by the ***lessor***	=	**Lease Term**
9 months		**Additional analysis required…**		**N/A**		**N/A**		**?**

Evergreen agreement – Lease term example

Lease term analysis – optional renewal – continued:

One approach could be to determine when the cost of penalties ($3,400) would **no longer be more-than-insignificant** in relation to LE's cumulative rent ($2,000/mo). Once insignificant, there will no longer be an incentive to renew the lease.

Total Months	Cum Rent	Penalty	Penalties as %
9	$ 18,000	$ 3,400	18.9%
12	$ 24,000	$ 3,400	14.2%
18	$ 36,000	$ 3,400	9.4%
24	$ 48,000	$ 3,400	7.1%

LE concludes there is a lack of economic incentive or other incentives to cause them to renew the lease after 18 months (9 month renewal period).

Lease term analysis:

Non-cancellable period	+	Optional renewal periods if lessee is ***reasonably certain*** to exercise	+	Periods after optional termination date if lessee ***reasonably certain*** ***not*** to exercise optional termination	+	Optional periods to extend (or not to terminate) the lease in which exercise of option is controlled by the ***lessor***	=	**Lease Term**
9 months		**9 months**		**N/A**		**N/A**		**18 months**

Other Industry related lease matters

Rigs

Key considerations:

- Is the rig explicitly or implicitly identified in the drilling contract?
- Any rig customization for the drilling site?
- Predominate characteristics of the arrangement

Specific contract considerations:

- Who controls the decision making?
- What type of payment terms (per day, per foot, per well)?
- Geographical limitations?

Rights of ways

Key considerations:

What is the duration?

- Perpetual (outside the scope of ASC 842)
- Contract of 99 years or 999 years is within the scope of the standard
- Stated term (including automatic renewals)

What is the unit of account (entire area, one piece of property, etc.)?

Is the right of way above ground (and if so, how much) or below ground?

Consider the natural resource scope exception (if applicable)

Current expected credit losses (CECL)

Topic 326 – Financial instruments – Credit Losses

What is Topic 326?

New standard replacing the incurred loss impairment model that recognizes losses when a probable threshold is met with a requirement to recognize lifetime expected credit losses immediately when a financial asset is originated or purchased.

What are the main areas of change?

- Requires earlier recognition of credit losses – removes probable threshold
- Recognizes lifetime expected credit losses
- Considers expected recoveries of amounts previously written off and expected to be written off
- Considers future economic conditions

Who/what is in scope?

Applies to all entities and certain financial instruments.

- Financial assets measured at amortized costs
- Net investment in a lease
- Held to maturity debt instruments
- Contract assets

CECL: Loss estimate model

Adjustments to historical loss information

Historical loss experience + Differences in asset-specific characteristics + Current conditions + Reasonable and supportable forecasts + Effects of reversion = Estimate of current expected credit losses

Differences in economic conditions

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Potential Impact on commercial entities

Impact depends on the type and amount of assets an entity holds.

Product	Potential impact	
	Higher	Lower
Short-term trade receivables		✓
Long-term trade receivables	✓	
Investments in HTM debt securities	✓	
Net investment in leases	✓	
Contract assets		✓
Investments in AFS debt securities – non-credit impaired		✓
Investments in AFS debt securities – credit impaired	✓	

Other considerations for oil & gas entities

What are the relevant economic factors to consider (e.g. energy prices, inflation, geopolitical factors)?

Should entities develop historical loss rates for very short-term assets currently assessed qualitatively?

How relevant is historical loss data?

What if economic conditions change? How will entities adjust loss estimates up or down?

Are existing KPIs still relevant under CECL, or should they be updated?

Comparison to existing practices for trade AR

	Current reserving (Incurred loss)	CECL
Projection horizon	Current reporting date (often based on days past due)	Contractual life of receivable
Macroeconomic factors	Current conditions – not forward looking	Reasonable and supportable forecasts
Aggregation	Pool or receivable level	Pooling required where risk characteristics are similar
Qualitative considerations	Allowed	Required for any in-scope factors not incorporated quantitatively
Discounting	Not commonly used	Optional
Multiple economic scenarios	No	Optional
Losses on unfunded commitments	Yes, if probable that a loss has occurred	Yes, through lifetime, except for unconditionally cancellable commitments

Definition of a business

Key changes

What are the key changes?

— New framework for determining whether transactions should be accounted for as acquisitions (or disposals) of a group of assets or a business

Step 1 Is substantially all of the fair value of the gross assets acquired concentrated in a single asset or group of similar identifiable assets?

If **yes**, the set is not a business. If **no**…

Step 2 Evaluate whether an input and a substantive process exists...
Does the set have outputs?

If yes…

The set is a business if it includes input(s) and one or more of the following:

— An organized workforce with skills, knowledge, or experience critical to continue producing outputs;

— A process that cannot be replaced without significant cost, effort, or delay; **or**

— A process that is considered unique or scarce.

If no…

The set is a business if it includes:

— Employees that form an organized workforce with skills, knowledge, or experience to perform an acquired process (or group of processes) that is critical to the ability to create outputs; **and**

— Input(s) that the workforce could develop or convert into outputs.

GAAP definition vs. S-X Article 11 definition

CAQ SEC Regulations Committee meeting – March 23, 2017

FASB ASU 2017-01: If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not considered a business.

S-X Article 11: The term "business" is evaluated based on the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions such that disclosure of prior financial information is material to an understanding of future operations.

— Presumption in S-X Rule 11-01(d) is a separate entity, subsidiary, or division is a business.

— A lesser component, such as a product line, also may be considered a business depending on the facts and circumstances.

— Section 2010.2 of the Financial Reporting Manual indicates: "The staff's analysis of whether an acquisition constitutes the acquisition of a business….focuses primarily on whether the nature of the revenue producing activity previously associated with the acquired assets will remain generally the same after the acquisition. New carrying values of assets, or changes in financing, management, operating procedures, or other aspects of the business…typically do not eliminate the relevance of historical financial statements."

SEC staff: **No change** in interpretation/application of Article 11 of Regulation S-X

Considerations regarding single or similar oil and gas assets

Assets attached to each other

- Working interests and infrastructure necessary for the wellhead to produce
- Pipelines and rights-of-use assets
- Processing and gathering systems supporting multiple working interest owners (careful assessment required)

In-place lease intangibles related to leased assets

- Favorable and unfavorable gathering, processing, or transportation contracts and their related tangible assets

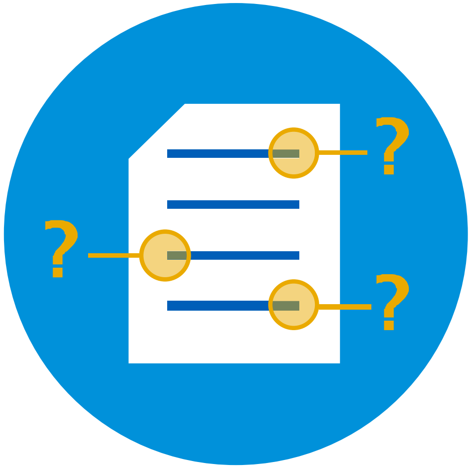
Additional risk factors specific to oil and gas properties (whether proved or unproved)

- Type of commodity (output)
- Geological formation
- Jurisdiction (laws and regulations)

Critical audit matters (CAMs)

Critical audit matters

Communicated as part of the auditor's opinion for audits performed under PCAOB standards



CAMs = matters that are:

- communicated, or required to be communicated, to the AC;
- relate to accounts or disclosures that are material to the financial statements; and
- involve especially challenging, subjective or complex auditor judgment.

Items to communicate for a CAM

Identify the CAM	Describe principal considerations in determination	Explain how the auditor addressed the CAM	Refer to related financial statements or disclosures
The 'What'	**The 'Why'**	**The 'Response'**	

Critical audit matters

The PCAOB's communication of 'critical audit matters' (CAMs) standard **is effective:**

— **for audits of large accelerated filers: fiscal years ending on or after June 30, 2019**; and

— for audits of all other companies to which the requirements apply: fiscal years ending on or after December 15, 2020.

Effective dates new standards

Public entities

Standards	Effective for years ending December 31	
	2019	2020
ASU 2016-02, 2017-13, 2018-01, 2018-10, 2018-11, 2018-20 & 2019-01, *Leases*	✓	
ASU 2017-08, *Premium amortization for purchased callable debt securities*	✓	
ASU 2017-11, *(Part I) Accounting for certain financial instruments with down round features*	✓	
ASU 2017-12, *Targeted improvements to accounting for hedging activities*	✓	
ASU 2017-15, *Codification improvements to ASC 955, US Steamship Entities*	✓	
ASU 2018-02, *Reclassification of certain tax effects from accumulated other comprehensive income*	✓	
ASU 2018-07, *Improvements to nonemployee share-based payment accounting*	✓	
ASU 2018-09, *Codification improvements*	✓	
ASU 2018-16, *Inclusion of the secured overnight financing rate (SOFR) overnight index swap (OIS) rate as a benchmark interest rate for hedge accounting purposes*	✓	
ASU 2019-04, *Codification improvements to Topic 326, Financial instruments—Credit losses, Topic 815, Derivatives and hedging, and Topic 825, Financial instruments*	✓	
ASU 2018-13, *Disclosure framework—Changes to the disclosure requirements for fair value measurement*		✓
ASU 2018-14, *Disclosure framework—Changes to the disclosure requirements for defined benefit plans*		✓
ASU 2018-15, *Customer's accounting for implementation costs incurred in a cloud computing arrangement that is a service contract*		✓
ASU 2018-17, *Targeted improvements to related party guidance for variable interest entities*		✓
ASU 2018-18, *Collaborative arrangements: Clarifying the interaction between Topic 808 and Topic 606*		✓
ASU 2016-13, 2018-19 & 2019-05, *Measurement of credit losses on financial instruments*		✓
ASU 2017-04, *Simplifying the test for goodwill impairment*		✓
ASU 2019-02, *Improvements to accounting for costs of films and license agreements for program materials*		✓

Non-Public entities

Standards	Effective for years ending December 31	
	2019	2020
ASU 2016-01, *Recognition and measurement of financial assets and financial liabilities*	✓	
ASU 2016-08, 2016-10, 2016-12 & 2016-20, *Revenue from contracts with customers*	✓	
ASU 2016-15, *Statement of cash flows – classification of certain cash receipts and payments*	✓	
ASU 2016-18, *Statement of cash flows – presentation of restricted cash*	✓	
ASU 2017-01, *Clarifying the definition of a business*	✓	
ASU 2017-05, *Clarifying the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets*	✓	
ASU 2017-07, *Improving the presentation of net periodic pension cost and net periodic benefit cost*	✓	
ASU 2017-15, *Codification improvements to ASC 955, US Steamship Entities*	✓	
ASU 2018-02, *Reclassification of certain tax effects from accumulated other comprehensive income*	✓	
ASU 2018-09, *Codification improvements*	✓	✓
ASU 2016-02, 2017-13, 2018-01, 2018-10, 2018-11, 2018-20 & 2019-01, *Leases* *(deferral proposed)*		✓
ASU 2017-08, *Premium amortization for purchased callable debt securities*		✓
ASU 2017-11, *(Part I) Accounting for certain financial instruments with down round features*		✓
ASU 2017-12, *Targeted improvements to accounting for hedging activities*		✓
ASU 2018-07, *Improvements to nonemployee share-based payment accounting*		✓
ASU 2018-07, *Improvements to nonemployee share-based payment accounting*		✓
ASU 2018-13, *Disclosure framework—Changes to the disclosure requirements for fair value measurement*		✓
ASU 2018-16, *Inclusion of the secured overnight financing rate (SOFR) overnight index swap (OIS) rate as a benchmark interest rate for hedge accounting purposes*		✓
ASU 2019-04, *Codification improvements to Topic 326, Financial instruments—Credit losses, Topic 815, Derivatives and hedging, and Topic 825, Financial instruments*		✓

Question and answer session

Thank you

Presenter’s contact details

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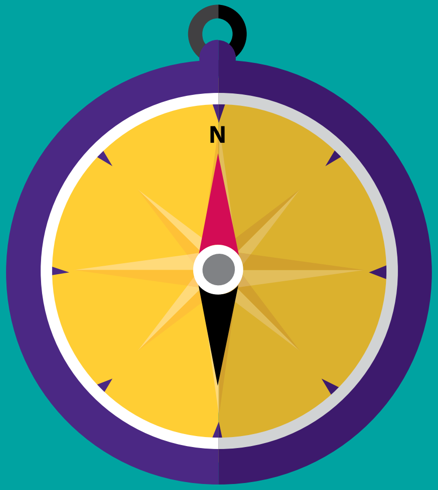

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