Aktuelle regnskapsmessige problemstillinger fra et selskaps ståsted

KRISTIANSAND SYMPOSIUM 15 Juni 2010

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Selected accounting issues from a preparers point of view

AGENDA

- Off-balance sheet commitments
- Financial lease – assets under construction
- Impairment

Leases and other commitments in Statoil

News 2010

New rig contracts signed

By Vidar Hardeland, GLD COM PL
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Statoil has awarded a contract to Dolphin AS and a le
Seadrill for two rigs which will operate on the Norweg
continental shelf (NCS).

The Bideford Dolphin rig has won a contract with Statoil for drilling o
Norwegian continental shelf. (Photo: Rune Johansen)

Secures transportation capacity to US premium gas market

Statoil has recently entered into transportation agreements in the US ensuring the right to transport and deliver natural gas produced in the Northern Marcellus shale gas area of Pennsylvania (PA) to the New Jersey and New York City areas.

The transportation agreements secure access to some of the main pipeline systems for gas in the New York City area.

Statoil's US subsidiary Statoil Natural Gas (SNG) has concluded transportation agreements with Tennessee Gas Pipeline (a subsidiary of El Paso Corp), and Texas Eastern Transmission (a subsidiary of Spectra Energy Corp), ensuring Statoil the right to transport up to 2 billion cubic metres (bcm) per year/200 000

CONTENT FROM STATOIL.COM

Marcellus shale gas

Statoil has a 32.5% interest in the Marcellus shale gas acreage.

Statoil note disclosure 2009

Other commitments (capacity etc.);

Nominal minimum commitments at 31 December 2009:

(in NOK million)	Transport and terminal commitments	Refinery related commitments	Total
2010	8,676	715	9,391
	8,266	740	9,006
	7,121	938	8,059
	6,898	955	7,853
	5,881	971	6,852
	37,558	21,670	59,228
	74,400	25,989	100,389

Operating leases;

(in NOK million)	Operating leases	Operating sub lease
2010	14,017	(1,560)
2011	10,929	(736)
2012	7,990	(585)
2013	5,262	(589)
2014	1,860	(146)
Thereafter	3,097	(1,324)
Total future minimum lease payments	43,155	(4,940)

Investment commitments;

	2010	2011	Thereafter	Total
Construction in progress	12,136	8,643	6,756	27,535
Property, plant and equipment and other investments	1,946	68	3	2,017
Acquisition of intangible assets	253	9	0	262
Subtotal joint venture related commitments	14,335	8,720	6,759	29,814
Non Joint Venture related:				
Construction in progress	734	0	0	734
Total	15,069	8,720	6,759	30,548

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Statoil note disclosure 2009, cont.

- Guarantees
- Insurance
- Wells
- Significant litigation
- Significant other disputes

Leasing and Other Commitments – a current overview

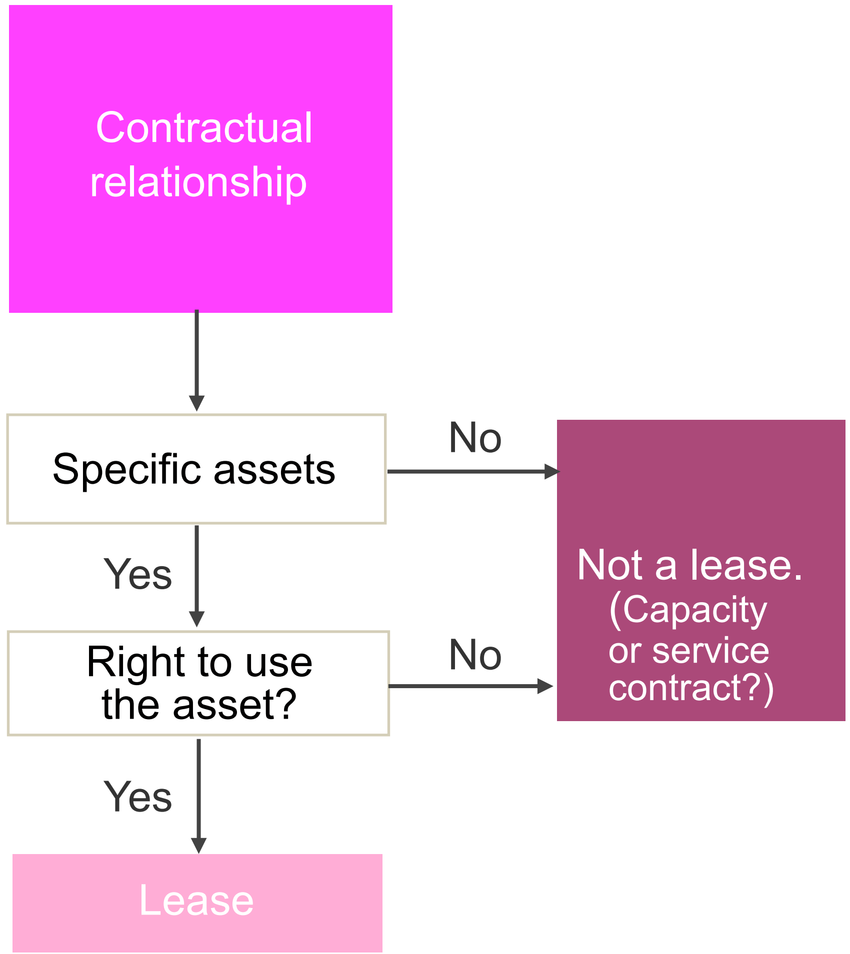
- **Two types of leases**
  - Operational lease, => off balance sheet (operating cost)
  - Finance lease, transfers risks and rewards of asset to lessee, => on balance sheet

- **Distinguishing ”lease” from other type capacity contracts**
  - May determine off-balance or on-balance sheet accounting
  - Partial arrangements for integrated, undivided assets such as pipelines, terminals
    - Partial leases not ”leases” for accounting purposes?
  - IFRS moves towards full capitalisation of all leases, but not yet of capacity contracts
    - Impact on companies' reporting of leases vs. other commitments in 2009 and beyond?

- **Classification of an agreement as an IFRS ”lease” means:**
  - Accounting for the agreement in accordance with IAS 17 / IFRIC 4
  - Disclosing the arrangements according to IAS 17 specific rules

Identifying “Leasing”

- “Leasing” in IFRS 17 / IFRIC 4 is based on determining whether an arrangement conveys the **right to use a specified asset**, even if other services are also performed
- Fulfilment must be **dependent on** the use of the ”specified” asset
  - **Supplier’s right and ability to provide alternative assets must be considered**
- Right to use = Right to control the use
  - **Payment for an asset to be available, rather than payment for the actual use, indicates “right to use”**



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”Specific Asset” (IFRIC 4.7 & 4.8)

- Scope: Mainly property, plant and equipment
  - Does not include leases to explore for or use minerals, oil, natural gas
  - Does not involve various licensing agreements for intangible rights (patents, copyrights)

- Fulfilment must be **dependent** on the use of a specified asset
  - Even if one asset is explicitly identified in the arrangement!
  - Main point for consideration: Does the supplier have the **Right and Ability** to provide service using other property, plant and equipment?

- Asset has been **implicitly** specified if:
  - The seller owns or leases only one asset with which to fulfil obligation, and it is not economically feasible or practicable for the seller to perform obligation through use of an alternative asset

Defining the ”right to use” that represents a lease (IFRIC 4)

- Right to use = Right to **control the use**

- Purchaser has a right to control the use of an asset if the arrangement meets <u>any one</u> of the following conditions:
  - ***Purchaser may operate asset or direct others to operate it, while controlling more than insignificant amount of the output***
  - ***Purchaser may control physical access to asset while controlling more than insignificant amount of the output***
  - ***Remote that anyone else than purchaser will take more than insignificant amount of asset's output. Price is neither contractually fixed per unit of output nor equal to current market price***
    - ***Ie. Agreed-upon payment for <u>availability of asset, not for its actual use</u>***

➢ May especially affect take-or-pay contracts

➢ “Substance over form”

When should assessment for possible lease be performed?

- Assess whether arrangement contains a lease **at inception** of arrangement

- Reassessment required if
  - Change in contract terms
  - Renewal option is exercised (only for option period)
  - Change in determination of whether a specified asset is required for fulfilment
  - Substantial change to the asset

- Reassessment to be made based on available facts at date of reassessment

Part of an asset: The subject of a lease?

- ***Non pro-rata portion of an asset***
  - Subject of a lease, if physically distinguishable from the larger asset. *For instance: One specific tank in a tank farm*
- ***Pro-rata undivided interest in an asset ("Partial lease")***
  - Current practice is that a direct pro rata undivided interest in an asset will not be the subject of a lease unless the pro-rata portion is "substantially all"
  - Company or ownership structure may alter this conclusion, as may the existence of *"joint control*" over an asset
- ***Lease entered into by a J/V where Statoil is partner***
  - If a J/V's 100% lease is financial in nature under IFRS, Statoil includes its share of the financial lease in the balance sheet in line with assets directly owned by the J/V
- **Jointly controlled asset:**
  - Pro-rata accounting for each venturer's share of asset in the balance sheet. Requires unanimous consent in decisions

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Discussion points:

When would the following be specified assets as defined by IFRIC 4?
When would they not be?
What are the accounting implications?

- ✓ Pipeline between a landing point and a specific point of sale
- ✓ Crude carrier services
- ✓ Truck transport services
- ✓ Specialized LNG carrier constructed to accommodate customer requirements
- ✓ Re-gasification terminal, attached to nationwide gas pipeline grid

Discussion points:
IFRS leases or not?
What are the accounting implications?

- **Pipeline transport agreement;**
  - Statoil has take-or pay agreement for the entire pipeline capacity, 1 year
  - Statoil has take-or pay agreement for the entire pipeline capacity, 20 years
  - Statoil is a 20% partner in a J/V which has a joint agreement for the entire pipeline capacity
  - Statoil has take-or pay obligations for 100% of a section of a pipeline, from landing point A to entry point B, but the pipeline is longer and used by others from point B and onwards to point C
  - Statoil has take-or-pay obligations for 15% of a pipeline owned and operated by a third party

Ongoing IFRS Development: Discussion Paper on Leases – ED expected June 2010

- Discussion Paper (DP), March 2009. Proposes significant changes to lease accounting:
  - **Both operational and financial leases to be accounted for as assets/liabilities**
    - Asset: Right of use, estimated at probability weighted cash flows
    - Liability: Obligation to pay rentals, cash flow over most likely lease term
    - Reassessment of obligations/ asset at each subsequent reporting term
    - Considerable estimation issues
- **Importance of distinction between lease accounting (on-balance) and service/capacity contracts (off-balance) will increase and come into users' focus**
- Consequences if final standard equals the DP;
  - All operational leases to be accounted for as assets and obligations, considerable impact on balance sheet, and significant process and system changes

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Operating Lease Commitments, note disclosure

- **IAS 17.35**
- **Lessees shall, in addition to meeting the requirements of IFRS 7, make the following disclosures for operating leases:**
  - **(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:**
  - **(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date.**

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Note Disclosures (cont'd)

- **Other Commitments (off balance), disclosure requirements:**
  - **Capacity commitments that are not leasing** – fallback to IAS 1 (and IAS 17 by analogy?)
    - IAS 1; 112 c – **"The notes shall provide information that is not presented elsewhere in the Fin. Statements but is relevant to an understanding of them"**
    - IAS 1; 114 d – "other disclosures, including (i) contingent liabilities and unrecognised contractual commitments"
    - **Similarity to leasing**, may indicate same level of information to be given
    - Materiality of arrangements to be considered
    - **Involves judgement in establishing level of reporting**
    - **Also refer by analogy to USGAAP's more detailed requirements when IFRS is silent**, as is also done for instance for reserve reporting
  - **Investment obligations (capital commitments) in IAS 16 (PP&E)**
    - 16.74.c: Disclose amount of contractual commitments for the acquisition of PP&E
  - **Investment obligations (capital commitments) in IAS 31 (Investments in Joint Ventures)**
    - IAS 31 Joint Ventures also has impact for any leases/commitments etc. included through "pro-rata consolidation"
    - 31.55.a&b: Capital commitments of a venturer in relation to interests in J/Vs and its share in the capital commitments that have been incurred jointly with other venturers, <u>and</u> its share in the capital commitments of the joint ventures

Discussion Points –

Experienced or expected development in the near term?

- ”Partial lease” still an off balance sheet item
- Importance of identification and evaluation of the ”specified asset” criterion for lease classification
- Extent of additional disclosure about significant terms (e.g. options, variable amounts etc.)
- Experienced impact of financial unrest on analysts/ rating agencies / financial statement users’ focus on off-balance sheet leasing and other commitments

Selected accounting issues from a preparers point of view

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Financial lease for assets under construction

IAS 17 Leases: "A *finance lease* is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset."

IAS 17 par 4 – Commencement of the lease term: "the date from which the lessee is entitled to exercise its right to use the leased asset"

What when a finance lease is of an asset with a significant construction period?

Historically Statoil applied US GAAP which has more guidance

Financial lease for assets under construction

Statoil Accounting manual (established policy):

Financial lease of asset under construction

If a financial lease arrangement involves an asset that will be constructed in connection with the lease agreement, it is necessary to evaluate whether the asset should be recorded on the lessee's balance sheet as an "asset under construction". Each such case must be evaluated in detail, but as a general rule, the lessee should record the asset under construction if the lessee has **substantially all of the construction period risk**.

IAS 17 par 4 Finance lease: "… transfers substantially all the risks and rewards incidental to ownership of the asset …"

Analogy to buying – e.g. when do we recognise cars/PC's/copiers in the balance sheet; when do we recognise vessels or buildings already built and used by others when signing vs. built on our specification – transfer of risk

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IAS 36 – Impairment of assets

- Impairment: An asset is impaired when its carrying amount exceeds its recoverable amount.
- Carrying amount: the amount at which an asset is recognised in the balance sheet after deducting accumulated depreciation and accumulated impairment losses
- Recoverable amount: The higher of an asset's fair value less costs to sell and its value in use.
  - Fair value: Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction
  - Value in use: The discounted present value of estimated future cash flows expected to arise from:
    - the continuing use of an asset, and from
    - its disposal at the end of its useful life.

IAS 36 – Indications of impairment

- <u>External sources:</u>
  - market value declines
  - negative changes in technology, markets, economy, or laws
  - increases in market interest rates
  - company stock price is below book value
- <u>Internal sources:</u>
  - obsolescence or physical damage
  - asset is part of a restructuring or held for disposal
  - worse economic performance than expected

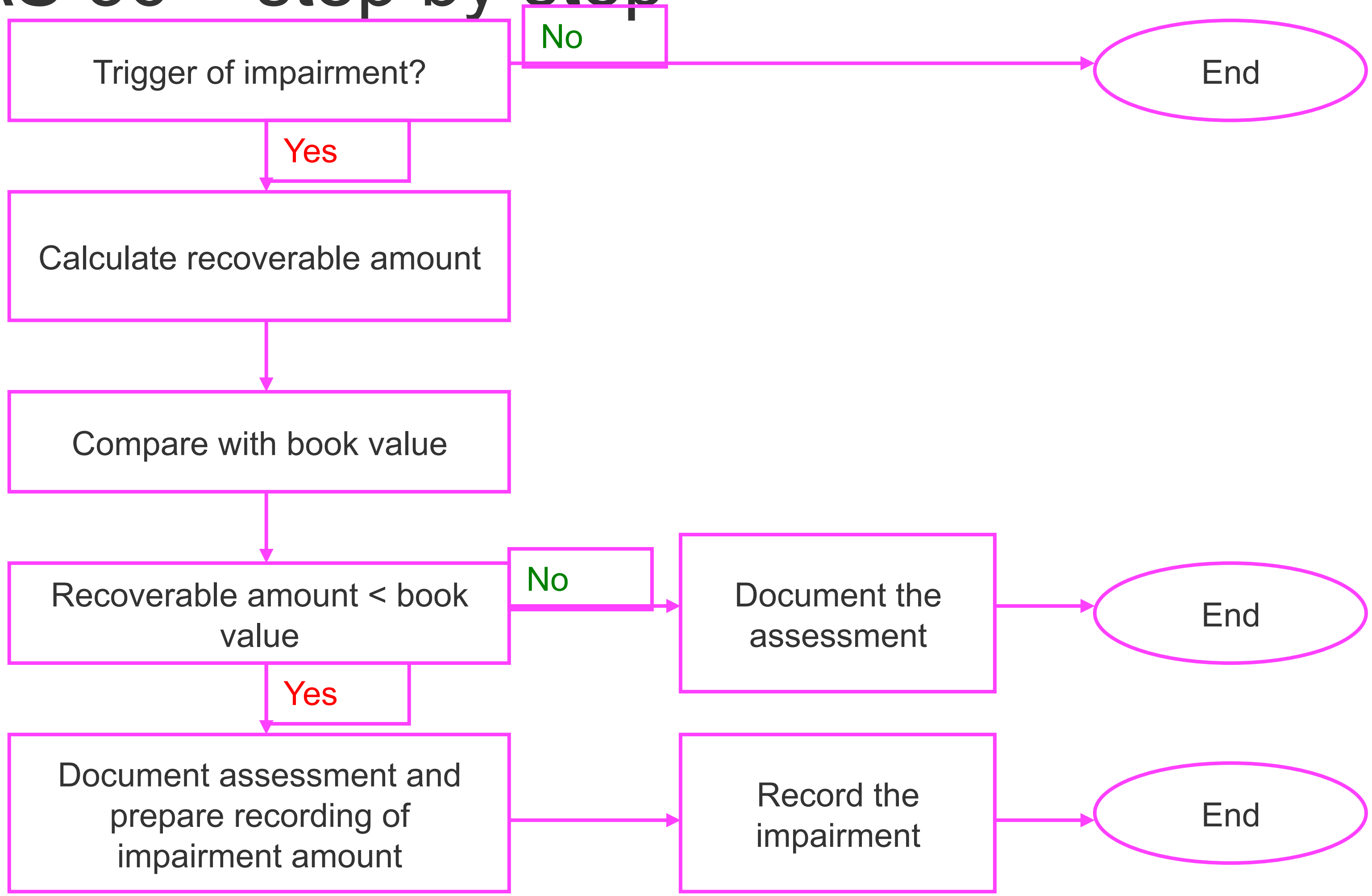
- Further, an indication that an asset may be impaired may indicate that the asset's useful life, depreciation method, or residual value may need to be reviewed and adjusted. [IAS 36.17]

Impairment

What is the cash-generating unit

Statoil: “Normally, separate cash-generating units are individual oil and gas fields … . For capitalised exploration expenditure, the cash-generating units are individual wells.”

IAS 36 – step by step



Impairment – Statoil accounting policies

Impairment

Impairment of intangible assets and property, plant and equipment

Statoil assesses assets or groups of assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Individual assets are grouped based on levels with separately identifiable and largely independent cash inflows. Normally, separate cash-generating units are individual oil and gas fields or plants. For capitalised exploration expenditure, the cash-generating units are individual wells.

In assessing whether a write-down of the carrying amount of a potentially impaired asset is required, the asset's carrying amount is compared to the recoverable amount. Frequently the recoverable amount of an asset proves to be Statoil's estimated value in use, which is determined using a discounted cash flow model. The estimated future cash flows are adjusted for risks specific to the asset and discounted using a real post-tax discount rate based on Statoil's post-tax weighted average cost of capital (WACC). Statoil considers post-tax calculations sufficiently objective and consistently applicable across the various tax regimes, while still for all significant purposes leading to the same conclusion that application of pre tax rates in accordance with IAS 36 Impairment of assets would have yielded.

If assets are determined to be impaired, the carrying amounts of those assets are written down to the recoverable amount which is the higher of fair value less costs to sell and value in use.

Impairments are reversed as applicable to the extent that conditions for impairment are no longer present.

Impairment

Impairment of Assets – IAS 36

- Higher of “fair value less costs to sell” and “value in use”
- Fair value in binding agreement or active market prices (IAS 36.25-26)
- Fair value in inactive market – price in most recent transactions for similar assets within the same industry (IAS 36.26-27)
- Fair value determined by estimates, averages and computational short cuts (IAS 36.23)
  - May include discounted cash flows – based on market assumptions

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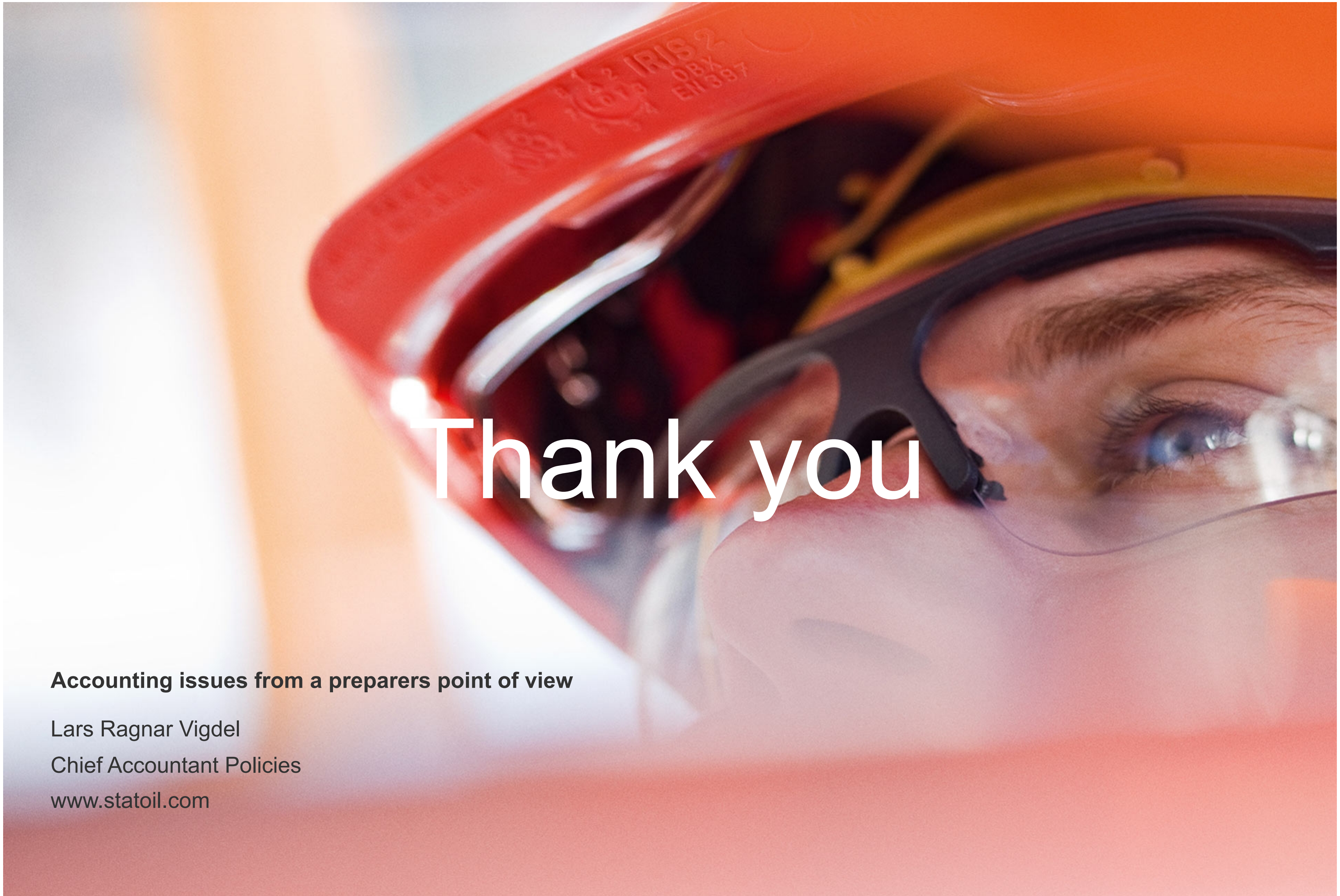

Thank you

Accounting issues from a preparers point of view

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Chief Accountant Policies

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