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Comment Letters Surrounding New Revenue Recognition Standard Reveal Issues

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Public energy companies are now one year in on their implementation of ASC 606, Revenue From Contracts With Customers, the revenue recognition guidance that reformed and replaced ASC 605. The crux of the new guidance requires revenue recognition when control of goods or services transfers to the customer, rather than an evaluation of when risks and rewards transfer. Although the energy industry may be considered a “lower impact” sector, don’t be fooled. Each major segment of the industry – upstream, midstream and downstream – is affected, and SEC comment letters surrounding the implementation and the qualitative and quantitative disclosure requirements required in ASC 606 have identified key themes that should be recognized by public companies during their second reporting year.

The top of the list of trending comments includes questions surrounding the identification and proper disclosure of appropriate performance obligations. Business within the midstream sector can involve multiple contracts related to the transportation, storage and wholesale marketing of crude or refined petroleum products. If the identified performance obligations are distinct or combined, an adequate explanation needs to be disclosed. Likewise, if it’s determined that all contracts have a single performance obligation, consideration of ASC 606 must be made. For a related upstream example, producers operating under product sales contracts should disclose that the unit of measure, such as barrel of oil or MMBTU of natural gas, is separately identifiable and represents a distinct performance obligation. The comment trend has shown that registrants need a detailed analysis of whether goods or services are distinct or should be combined.

Another key comment letter trend involves transfer of control. SEC staff has asked for more transparency as to whether control transfers at a point in time versus over time. The upstream and midstream impact related to the sector’s intricate gas processing arrangements must be assessed as to when the control of wet gas is transferred. Along with the crucial “principal versus agent” determination, the wet gas transfer generally takes place at either the wellhead or the tailgate of the plant. Depending on where and when that control transfers, the revenue is either presented as net or gross of the amounts remitted to the third party. The SEC has remitted comments urging companies to provide robust disclosures for control conclusions relating to processing arrangements.

Disaggregated revenue disclosures, and the manner in which disaggregation categories are determined, was also identified as a comment trend and raises an issue applicable to all sectors. An example of an upstream instance would involve a producer with material drilling operations in multiple basins. The company must

evaluate whether production revenues should be further disaggregated by geographical basin in the footnotes to the financial statements based on revenue/volume disaggregation in earnings releases, investor presentations and key internal reports. Although the most common categories presented in tabular disclosure are product line and geographical region, these must be assessed in accordance with ASC 606.

The SEC staff comment trends have primarily related to aspects of the new standard that require judgment. It's important to keep in mind that the goal of the revenue standard is to increase transparency to investors regarding a company's revenue contracts and accounting policies. The energy sector is complex and the effects of ASC 606 are pervasive. Because of that, revenue recognition footnote disclosures for your next reporting period should be examined by your finance department and your assurance firm in the areas noted above.

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