Accounting for revenue is changing

What's the impact on oil and gas companies?

In association with the KPMG Global Energy Institute

September 2016

The new revenue standard – effective from 1 January 2018 – is likely to affect the way you account for revenue. But it is more than just an accounting change.

It could impact:

- complex arrangements with partners
- arrangements involving engineering, construction and maintenance
- timing of revenue recognition for production- or sales-based royalties
- timing of revenue recognition for take or pay arrangements
- systems and processes, including data collection
- disclosures in annual and interim reports

It's time to engage, particularly as there are also new standards on leases and financial instruments.

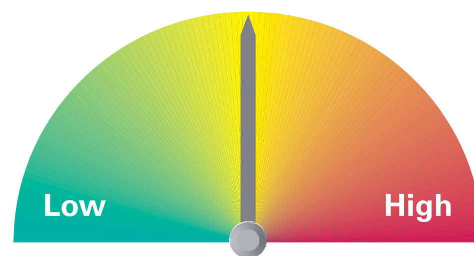
If you have:

- collaborative arrangements
- oil and gas lifting imbalances
- production- and sales-based royalties
- take or pay arrangements
- long-term sale contracts
- contracts with multiple goods and services

…it's time to start looking at your contracts and assessing how the new revenue requirements will affect your business.

Engage with your stakeholders to build up expectations of how your KPIs or business practices may change.

Determining the impact



Collaborative arrangements

Potential impact

- Oil and gas companies often enter into diverse collaborative arrangements that can be complex.
- IFRS 15 excludes from its scope contracts with a collaborator or a partner that are not customers. However, a contract with a collaborator or a partner is in the scope of the new standard if the counterparty meets the definition of a customer for part or all of the arrangement.
- Oil and gas companies will need to carefully consider all facts and circumstances of their collaborative arrangements to determine whether they fall in the scope of the new revenue standard – even if for only parts of the arrangement.

Actions to consider

- Review the terms of the arrangements with partners and collaborators to determine if the counterparties meet the definition of a customer or the arrangements fall outside the scope of IFRS 15.
- Engage with partners and collaborators early to ensure that the accounting impact of any contract renegotiations close to the transition date are captured and understood.

Oil and gas lifting imbalances

Potential impact

- Oil and gas companies may make payments to each other to settle imbalances that arise when the amount lifted by one partner differs from its proportionate entitlement. Currently, such payments are accounted for in a number of ways, with the sales method and the entitlements method being two common approaches.
- Under IFRS 15, only consideration from contracts with customers is recognised as revenue. Therefore, oil and gas companies will need to carefully consider if all amounts currently reported as revenue could continue to be reported as such under the new revenue standard.

Actions to consider

- Review the terms of the arrangements involving settlements for lifting imbalances to determine if the partners meet the definition of a customer for part or all of the arrangement or the arrangement falls outside the scope of IFRS 15.

Production- and sales-based royalties

Potential impact

- Some arrangements involving sales of assets in the oil and gas industry may include variable consideration (referred to as 'royalty') that is based on the subsequent performance of the asset – i.e. production or sales levels.
- Currently, some oil and gas companies recognise variable revenue from such arrangements as production or sales occur.
- Under IFRS 15, variable consideration is estimated and included in the transaction price to the extent it is highly probable that there will be no significant reversal in the amount of cumulative revenue recognised when the uncertainty is resolved.
- This new approach to variable revenue may accelerate the recognition of revenue that depends on future production or sales levels, though the operation of the constraint will limit the impact of this when there is significant estimation uncertainty about future production or sales levels.

Actions to consider

- Review the terms of the arrangements involving production- and sales-based royalties and assess implications for accounting and financial reporting.
- Develop processes, adjust systems and internal controls to capture, report, monitor and re-assess contracts with variable consideration and related features.

Take or pay arrangements

Potential impact

- IFRS 15 features a new approach for arrangements in which customers do not exercise all of their contractual rights (i.e. breakage). This may affect take or pay arrangements in which customers may not take all of the output to which they are entitled.
- Under IFRS 15, if an oil and gas company expects to be entitled to breakage, then it recognises the estimated breakage amount as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, breakage is recognised as revenue only when the likelihood of the customer exercising its rights becomes remote. This may change the timing for recognition of breakage revenue.

Actions to consider

- Review the contractual terms and business practices relating to take or pay arrangements and assess the implications on accounting and financial reporting.
- Develop accounting procedures needed to determine the treatment of breakage in take or pay arrangements.
- Develop processes, systems and internal controls needed to identify and report take or pay arrangements and their key features.

Long-term sale contracts

Potential impact

- Entities that enter into long-term sale agreements will need to consider if the accounting for such contracts may change under IFRS 15. Examples of clauses that may require analysis include variable pricing, additional volume options and deferred or advanced payment terms.
- Entities will need to consider the following areas of guidance when making the evaluation:
  - accounting for variable consideration (application of the 'constraint');
  - options to purchase additional product; and
  - the time value of money when delivery of the goods and payment are 12 or more months apart (which applies to both advanced and deferred payments).

Actions to consider

- Review the contractual terms and business practices relating to long-term sale contracts and assess the implications on financial reporting.

Contracts with multiple goods and services

Potential impact

- IFRS 15 includes new requirements on how to determine whether the various goods and services promised in a contract are accounted for as separate performance obligations, or as a single performance obligation, including a series of goods or services.
- If separate performance obligations are identified, then oil and gas companies are required to allocate the transaction price to the performance obligations based on the relative stand-alone selling prices of the goods and services.
- This may affect, for example, arrangements involving engineering, procurement, manufacturing, construction or maintenance services.
- For each performance obligation, a separate assessment is then required as to whether revenue is recognised at a point in time or over time. This may result in a different revenue profile compared to current practice.

Actions to consider

- Review arrangements involving multiple goods and services to determine performance obligations under the new standard. Develop new processes and adjust systems and internal controls to capture, estimate and monitor stand-alone selling prices to allocate the transaction price to the performance obligations in the contract.
- Assess whether billing management and related systems and internal controls are capable of supporting the allocation methodology and generation of information needed to allocate revenue.
- Exercise judgement in assessing whether revenue should be recognised at a point in time or over time.

New disclosures

Potential impact

- Extensive new disclosures are required, incorporating both qualitative and quantitative information. There are no exemptions for commercially sensitive information.
- Stakeholders and competitors may take a close interest in the new disclosures related to unsatisfied performance obligations, as they convey information about future activity.
- Regulators are expecting detailed disclosures about implementation plans and the impact of the new revenue standard in interim and annual reports, with some pushing for quantification of the expected impact not later than the 2017 annual report.

Actions to consider

- Perform an initial assessment of whether existing systems and processes can collect the data necessary to compile the new disclosures.
- Develop, test, and document any new internal controls that need to be established over the systems and process changes.

Transition options[1]

Potential impact

- IFRS 15 may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the comparative period.
- Alternatively, IFRS 15 may be adopted as of the application date, by adjusting retained earnings at the beginning of the first reporting year (the cumulative effect approach).

Actions to consider

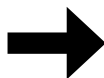
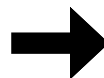
- Quantify and evaluate the effects of the different transition options, including the available practical expedients under the retrospective approach.
- Perform a historical analysis of key contracts. Consider whether existing systems provide the data required to produce comparative information if the new standard is applied retrospectively.

The KPMG Global Energy Institute (GEI)

Launched in 2007, the GEI is a worldwide knowledge-sharing forum on current and emerging industry issues. This vehicle for accessing thought leadership, events, webcasts and surveys about key industry topics and trends provides a way for you to share your perspectives on the challenges and opportunities facing the energy industry – arming you with new tools to better navigate the changes in this dynamic area. A regional focus to the GEI provides decision makers with tailored insight within the North and South America, Asia Pacific and Europe, Middle East & Africa regions. To become a member of GEI visit kpmg.com/energy

1. You can find more detailed information about IFRS 15 in our publications *Transition to the new revenue standard* and *Issues In-Depth*.

KPMG can help

Assess the impacts  Design a tailored approach  Help implement a future state

A robust assessment phase is critical to laying the framework for a successful project, and it is important to start the assessment early to provide flexibility during the implementation phase. An assessment phase typically includes the following activities:

Activities	Actions	Deliverables
Accounting diagnostic	– Identify potential gaps to accounting policy and disclosures by reviewing current accounting policy and sample of contracts – Leverage your existing documents and knowledge	Gap matrix, heat map and contract review summaries
Process and information gap analysis	– Identify new information and process requirements – Trace requirements to existing sources or identify gaps	Business requirements document, process and information gap analysis report
Technology and broader impact evaluation	– Identify potential impact on IT, tax, controls, operations, FP&A, investor relations, etc. – Identify gaps and linkages across the organisation	Final gap matrix and heat map, implementation roadmap
Transition option assessment	– Determine how each option may impact financials and business – Assess readiness to elect the retrospective or cumulative effect option	Transition option assessment report

KPMG's Energy & Natural Resources practice

KPMG's Energy & Natural Resources practice is dedicated to supporting oil and gas companies globally in understanding industry trends and business issues. Member firms offer customised, industry-tailored services that can lead to value-added assistance for your most pressing business requirements. Our extensive network of professionals combines in-depth industry knowledge with extensive experience helping clients managing accounting transitions with what they entail.

Regina Mayor
Global Head, Energy and Natural Resources
T: 1 713 319 3137
E: rmayor@kpmg.com

Jimmy Daboo
Global Audit Leader, Energy and Natural Resources
T: +44 20 7311 8350
E: jimmy.daboo@kpmg.co.uk

Markus Kreher
Global Leader, Accounting Advisory Services
T: +49 89 9282 4310
E: markuskreher@kpmg.com

kpmg.com/ifrs

Publication name: *Accounting for revenue is changing: What's the impact on oil and gas companies?*

Publication date: September 2016

© 2016 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

KPMG International Standards Group is part of KPMG IFRG Limited.

KPMG International Cooperative ('KPMG International') is a Swiss entity that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind KPMG International or any other member firm, in any manner whatsoever.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.