

# Oil Industry Accounting Committee

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Dear Mr Hoogervorst

## Comment letter on ED/2013/6 Leases

### Introduction

The Oil Industry Accounting Committee (OIAC) welcomes the opportunity to comment on ED/2013/6 Leases.

OIAC act as a focal point for the UK-based oil and gas industry, with particular emphasis on the upstream segment of the industry's activities, in relation to financial reporting and disclosure issues. As such we have limited our response to those matters that will specifically impact our industry sector.

#### Question 1: Identifying a lease

*Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease, is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.*

We support the core principal of the proposed requirements that an entity should recognise assets and liabilities arising from a lease obligation. We are however concerned that the current proposed guidance for identifying a lease will give rise to a substantial "grey area" in its application to assets-with-services arrangements. This is a result of the current proposals requiring the customer to have the ability to direct the asset's use and derive the benefits from that use, which contrasts with current requirements under IFRIC 4 where the arrangement needs to be dependent on a specific asset and convey a right to use the asset.

In the oil and gas industry, significant assets are leased through the exploration, development and production phases of an oil or gas field's life cycle and frequently these assets come with services attached. A typical example will be the lease of a floating production storage and offloading facility (commonly referred to as an FPSO, this a vessel used for processing hydrocarbons and storing oil before it can be offloaded to a tanker). FPSOs are frequently provided on a "lease and operate" basis where decisions directing the use of the asset will often be shared by the customer and supplier or are to a great extent pre-determined, for example by industry standards. Following the proposed guidance, it could therefore be concluded that the control of the use of the vessel has not been conveyed to the customer and therefore the supply of the FPSO does not meet the definition of a leased asset, even though the fulfilment of the contract depends on the use of a clearly identified asset, and was accounted for as a lease under IFRIC 4.

We believe that the consequences of the revised guidance will lead to fewer assets meeting the definition of a lease and inconsistencies in the interpretation of lease contracts. Further guidance is therefore

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required in this area if consistent treatment of arrangements that contain both the lease of assets and the provision of services is to be achieved.

## Other matters

### **Interaction with IFRS 11 Joint Arrangements**

Oil and gas activities are most-commonly conducted through joint arrangements which rely on leased assets. The underlying lease agreements may be with a joint venture entity, directly with several joint arrangement partners or with a single partner in a joint arrangement (the “operator”), who will subsequently recharge the costs to fellow partners. The current proposal defines the lessee as the entity entering into the contract and does not address instances where the entity is either a joint venture or is acting on behalf of a joint arrangement.

It is not uncommon for assets to be leased and used across several joint arrangements. For example, a drilling rig may be leased by an operator for an exploration drilling programme across several different exploration licences. Each licence will be managed through its own joint arrangement and the underlying parties to each joint arrangement will be recharged for their share of the rig lease costs.

Under the current proposals it is unclear as to whether the operator would be expected to recognise the full obligation for the rig for the duration of the lease term – which in our view would not reflect the underlying economics of the lease arrangement – or only the operator’s expected share of the lease expense, post recovery from partners. For those partners who have either jointly entered into a lease agreement or who will be recharged for their share from the operator, it is unclear whether they should recognise a right of use asset and liability or record nothing at all.

We do not believe that the structure of the joint arrangement should determine whether or not an asset is to be recognised through a lease arrangement and that further guidance is therefore required in this area.

Yours sincerely



Chris Hebden  
Chairman OIAC

