AMERICAN PETROLEUM INSTITUTE

Stephen Comstock
Director – Tax and Accounting Policy
1220 L Street, NW
Washington, DC 20005-4070
Telephone (202) 682-8455
Fax (202) 682-8408
Email ComstockS@api.org
www.api.org

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The Honorable Wesley R. Bricker
Chief Accountant
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Bricker and Mr. Golden,

As you know, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2016-02—Leases (Topic 842) ("the ASU") intended to improve financial reporting with regards to lease transactions. This ASU affects a large number of SEC registrants. Currently, the ASU is effective for public business entities for fiscal years beginning after December 15, 2018. The dramatic change in accounting versus current GAAP, the lack of software available to handle the variations and complexities of lease portfolios, and the effort required for companies to plan and implement the changes in a well-controlled manner together pose serious obstacles to a broadly effective implementation for U.S. preparers. The American Petroleum Institute (API), on behalf of its members, requests the support of the SEC and FASB to defer the implementation date of the ASU for two years, while maintaining an election to adopt earlier.

Our request for a delay in the effective date is not born out of a delay in our members engaging in implementation activities. In contrast, <u>months before the ASU was finalized and issued</u>, the API and its member companies periodically met to discuss and assess the impact of the proposed ASU. The API facilitated numerous discussions between member companies and representatives from EY, PwC, and KPMG to assist with interpretative issues. Certain of these issues were specific to the oil and gas industry, some applied to the broader energy industry (e.g. inclusive of refinery and pipeline/transportation companies), while others pertained to industries beyond energy. Two recent notable discussion topics were the application of the ASU's scope provisions to easements/rights-of-way and the current status of information technology solutions.

While many policy-related implementation issues are gradually being resolved by member companies, the state of readiness of software solutions creates a significant concern with regard to the ASU's current implementation date. Despite significant implementation planning efforts to date, member companies now recognize a significant accounting and financial reporting risk in successfully adopting the new ASU with respect to the extensive software upgrades required. Quite simply, some 18 months before the effective date of one of the most extensive accounting changes in the last two decades, the software and related support required for effective implementation does not yet exist. We believe these circumstances are not unique to the energy industry. Below is a condensed summary of the more significant challenges we believe all companies face as they work to adopt the new ASU:

1) **Technology Barriers:** While current lease administration software solutions exist that can serve as a central repository for contracts, many companies, especially multi-nationals, have a decentralized process for managing contracts and the deployment of such software today is limited. This makes it difficult to identify and gather all appropriate contracts and data elements to analyze under the new accounting standard. Moreover, the current technology of these systems does not capture all the relevant data points necessary for evaluation under the new ASU. As many as 200 data points must be captured for each lease contract in order to determine the appropriate accounting treatment. To gather the relevant lease-related metadata, it may be necessary to combine information that resides in Master Service Agreements with information in underlying Service / Product Agreements and amendments to such agreements, which may lead to recognition of many categories of right of use assets. The technology to extrapolate metadata to be used in the lease analysis is not mature. While "Machine Learning" seems to be the proposed technology to help extract such data from contracts, this technology is not advanced enough to recognize data, understand related patterns and draw relationships among non-homogeneous contracts. Without such technology, it will be costly and time-consuming to accomplish these tasks manually within the remaining timeframe to implement the standard.

   Another technological barrier pertains to tools that will help make the determination of whether a contract is within scope, and if so, whether it is an operating or a financing lease. While several consulting firms are working on the development of a tool, it will take some time to fully develop the underlying logic in the tool to make appropriate lease determinations.

   The most difficult challenge is that current lease administration systems do not generate the accounting entries required for ASC 842 and these tools are not designed to interface with existing Enterprise Resource Planning ("ERP") systems. The ERP systems themselves do not have lease modules that are fully compliant with the ASU. Software providers are building new systems, or upgrading their current products for compliance with ASC 842. These are at various stages of development, but none are mature, which is posing challenges for preparers beyond their control to effectively implement and test the new processes required before the January 2019 deadline.

2) **Availability of Vendor Resources:** A very limited number of vendors exist with which to partner and develop the appropriate software for the accounting systems. Of these vendors that market a potential solution, API member companies will require customization based on the unique characteristics of their specific accounting and ERP systems. These vendors must also be responsive to companies in all other industries affected by the ASU. As a result, vendor resources will likely become scarce during the most critical implementation window as companies seek to test and finalize their software solutions and processes.

3) **Extensive Manual Review and Control Requirements:** The process of assessing and recognizing a contract is time-consuming and more complex than most people, including standard-setters, might expect. Although a number of leases are of a high dollar amount, the vast majority of leases that need to be evaluated involve small value transactions that are high in volume which require coordinated, automated systems. Member companies currently estimate that the number of assets falling in scope of the ASU range from 1000 to 30000, excluding easements and right-of-way agreements which can number up to 100,000 for an individual company.

This task is further complicated by the existence of multiple amendments to long-lived contracts, use of non-standard terms and conditions, multiple originating functional organizations (e.g., supply chain, land, legal, IT, health & safety, marketing, operations, etc.), geographic diversity (e.g., country-specific requirements and/or multiple languages), multiple foreign currencies associated with contracts, and decentralized contracting processes. The large number of variables that can impact the underlying accounting will require member companies to evaluate an extensive number of their contracts, which precludes potential efficiencies available from the use of the portfolio approach allowed under the ASU.

Many times, those who are authorized to initiate leases are managers of the equipment and not accounting personnel. Without an appropriate control environment, there is ample opportunity for mistakes. Beyond evaluating leases at their initiation, an entity must then implement controls to review each lease at each reporting date and to identify and evaluate renewal and termination options in the portfolio that would result in a lease modification. This process constitutes a significant change from current practice in that contracts currently designated as operating leases will now directly impact the balance sheet, income statement and statement of cash flows. This new recognition pattern on the financial statements requires extensive evaluation of existing controls and design/implementation of new control processes and procedures.

According to survey data collected by PwC and EY[1],[2], API member companies represent one of many industries that are voicing growing concern over the technical aspects of implementation. As noted previously, many API companies have been able to devote a significant amount of time and effort assessing the Lease ASU and planning for implementation because the Revenue Recognition standard (effective 1/1/2018 for most companies) has limited impact in our industry. In contrast, many other industries have been focused on implementation of the Revenue Recognition standard, but are now just turning their attention to the Lease ASU. We believe an extension on the Lease ASU effective date will be welcomed by other industries as they ramp-up their implementation efforts.

Our member companies affirm their commitment to properly implement the Lease ASU. However, the incremental costs and potential financial reporting control risks posed by the absence of existing software capability will result in an implementation effort, both in our industry and beyond, that is neither efficient nor consistent across SEC registrants. The API respectfully requests that the SEC and FASB strongly consider extending the effective date of the ASU by two years, with an option to adopt early.

Sincerely,

Stephen Comstock
American Petroleum Institute

CC: Ms. Susan M. Cosper, Technical Director

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[1] EY Lease Accounting Survey Report. June, 27, 2017. http://www.ey.com/us/en/newsroom/news-releases/news-ey-lease-accounting-survey-finds-companies-anticipate-challenges-to-operationalize-changes-while-acknowledging-opportunity-for-business-benefit

[2] PwC 2017 Lease Accounting Survey Summary. https://www.pwc.com/us/en/audit-assurance-services/accounting-advisory/leasing-survey-2017.html