Oil Pipeline Accounting Issues and Updates

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Agenda

FASB standards update

1) Leases

2) Revenue

AOPL-sponsored industry accounting guideline

1) Background

2) Review of resolutions

- **Section 1:** Broad Account Classifications
- **Section 2:** Employment Related
- **Section 3:** General Accounting
- **Section 4:** Form 6 Reporting

FASB Standards Update

FASB Standards Update:
1) Leases

ACCOUNTING STANDARDS UPDATE NO. 2016-02

Accounting Standards Update No. 2016-02, Leases

On February 25, 2016, the Financial Accounting Standards Board (FASB) issued an **Accounting Standards Update (ASU)** to improve financial reporting about leasing transactions.

Who does it effect?

All companies and other organizations that lease assets like real estate, airplanes, and manufacturing equipment.

What does the update require?

The ASU will require organizations that lease assets—lessees—to recognize **on the balance sheet** the assets and liabilities for the rights and obligations created by those leases.

The accounting by organizations that own the leased assets—lessors—will remain **largely unchanged** from the prior standard (FAS 13, 1976).

Accounting Standards Update No. 2016-02, Leases (cont.)

What's the current system?

Under current model, an organization applies a classification test to determine the accounting for the lease arrangements.

What's the problem with the current system?

The existing operating lease model has been criticized for failing to meet the needs of users of financial statements because it does not always provide a **faithful representation** of leasing transactions.

- Fails to recognize assets and liabilities that clearly do exist
- Bright line classification test leads to mischaracterization

Accounting Standards Update No. 2016-02, Leases (cont.)

How will the ASU Improve Lease Accounting?

Improvements to Lease Accounting under the Update:
• Results in a more faithful representation of a lessee’s rights and obligations from leases
• Results in fewer opportunities for organizations to structure leasing transactions to achieve a particular outcome on the balance sheet
• Improves understanding and comparability of lessee’s financial statements
• Aligns lessor accounting and sale & leaseback transactions guidance more closely to comparable revenue guidance in the 2014 revenue recognition standard
• Provides users of financial statements with additional information about lessors’ leasing activities & lessors’ exposure to credit & asset risk as a result of leasing
• Clarifies the definition of a lease to address practice issues within current GAAP and to align concept of control, as used within the definition, more closely with control principle used in revenue recognition & consolidations

Accounting Standards Update No. 2016-02, Leases (cont.)

What does the new guidance do?

- A Lessee will now be required to recognize assets and liabilities for leases with lease terms of more than 12 months
- Unlike the current GAAP, the guidance in the ASU will require both leases to be recognized on the balance sheet
- The ASU permits private companies to use risk-free rates when determining the present value of lease liabilities
- The ASU will require ***disclosures*** to help investors and other financial-statement users better understand the amount, timing, and uncertainty of cash flows arising from leases
  - These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements

Accounting Standards Update No. 2016-02, Leases (cont.)

	Balance Sheet	Income Statement	Cash Flow Statement
Finance Lease	Right-of-use asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payments
Operating Lease	Right-of-use asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payments

Accounting Standards Update No. 2016-02, Leases (cont.)

Does the FASB's New ASU Differ from IFRS?

The main differences between this ASU and IFRS 16 relate to the lessee accounting model:

- **The lessee accounting model in the ASU:** Distinguishes between finance leases and operating leases in the financial statements
- **The lessee accounting model in IFRS 16:** Requires leases to be accounted for consistent with the approach for finance leases in the ASU

Thus, leases classified as operating leases under the guidance in the ASU will be accounted for differently under GAAP than under IFRS and will have a different effect on that statements of comprehensive income and the statement of cash flows.

Accounting Standards Update No. 2016-02, Leases (cont.)

When will the ASU be effective?

- **For Public companies:** The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 (for a calendar year company, it would be effective January 1, 2019).
- **For all other organizations:** The ASU is effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020.

Early application is permitted for all organizations.

What about Transition?

The ASU requires reporting organizations to take a modified retrospective transition approach.

- An organization that elects to apply the practical expedients will continue to account for leases that commence before the effective date in accordance with current GAAP unless the lease is modified.
- However, lessees are required to recognize on the balance sheet lease assets and lease liabilities for operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under current GAAP.

FASB Standards Update:
2) Revenue

Revenue From Contracts with Customers

Objectives of Update:

1) Removes inconsistencies and weaknesses in revenue requirements

2) Provides a more robust framework for addressing revenue issues

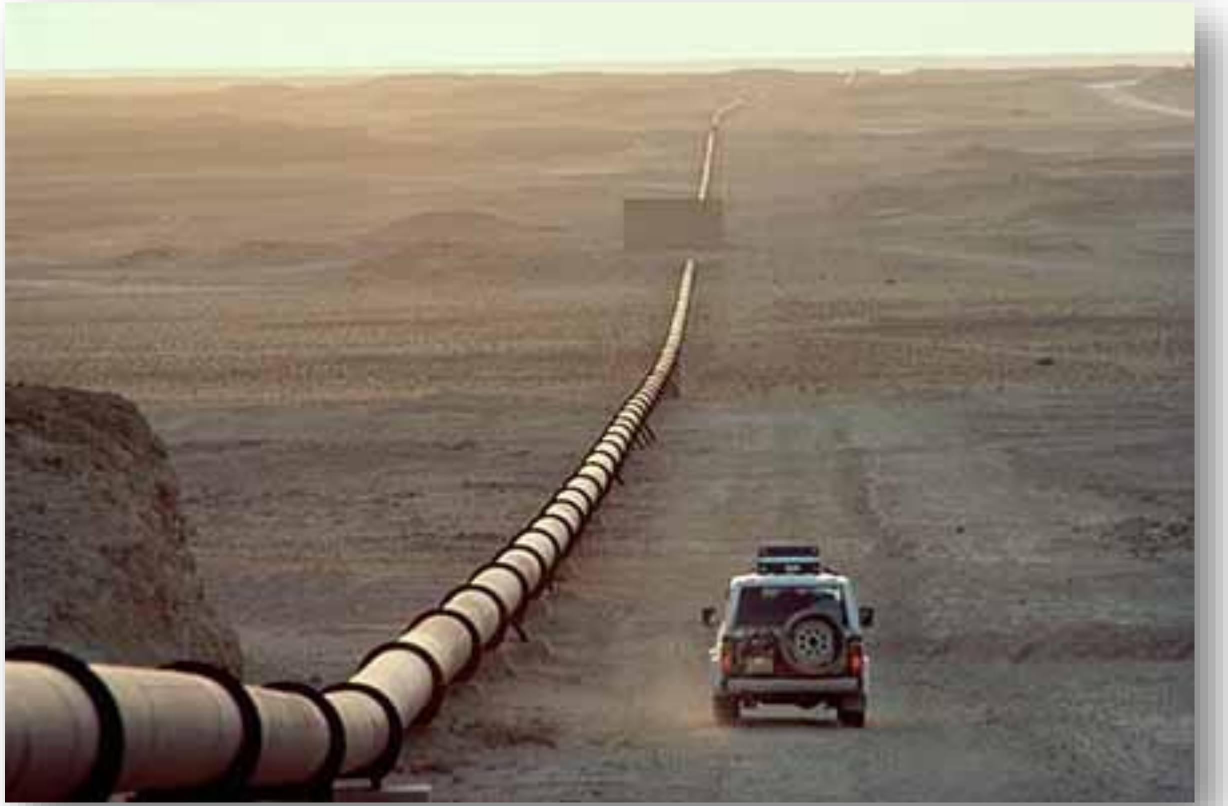
3) Improves comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets

4) Provides more useful information to users of financial statements through improved disclosure requirements

5) Simplifies the preparation of financial statements by reducing the number of requirements to which an entity must refer

Revenue Core Principles: 5 step process

1) Identify contracts with customers
2) Identify performance obligations in contract
3) Determine transaction price
4) Allocate transaction price to performance obligations
5) Recognize revenue when (or as) the performance obligation is satisfied



Oil Pipeline Industry Accounting Guideline

Oil Pipeline Industry Accounting Guideline:
1) Background

GUIDELINE INTRODUCTION AND OVERVIEW

Guideline Introduction

Origins

AOPL efforts to improve industry reporting

- Annual Form 6 training
- Validation checklist
- Electronic model

FERC inquiry (Docket RM07-9)

- February 2007 – Notice of Inquiry (NOI) into the need for Form 6 revisions to improve quality and usefulness of data
- July 2007 – FERC informal workshop
- September 2007 – AOPL post-workshop response to NOI

Purposes

Quality reporting to benefit industry and FERC

- Regulatory objectives
- Performance comparisons
- 5-year Index Study (AOPL)

Response to the Commission's inquiry

- Shippers proposed a massive increase in reporting requirements, which would fundamentally alter the nature, function, and burden of the Form 6.
- Carriers defended the current Form 6.
  - No basis for significant changes
  - Matter-of-fact compliance filing in good faith
  - Focus on overall quality and usefulness

AOPL Formal Comment to FERC (2007)

Validation checklist

- Tool to validate consistency of Form 6 data
- Industry has been developing for over a year
- Propose that Commission incorporate into filing software

Proposal

- **Objective** – "[increase] the uniformity of regulatory accounting interpretation and implementation among Form 6 filers."
- **Task Force** – "industry personnel who are uniquely qualified, as daily users of the USoA, to review and suggest improvements to the completeness of regulatory accounting standards."
- **Scope** – "comprehensive review of the USoA, including the Chart of Accounts, General Instructions, and Definitions."

AOPL Formal Comment to FERC (2007)

Initial Objectives and Process

- "…resolve on a single proposed interpretation and industry standard implementation approach for the areas … lacking in clarity"
- "… resolutions will include, augmenting the definitions of terms, providing examples of application … [and] more detailed instructions"
- "The results … would be compiled into a draft guideline for possible adoption by the membership of AOPL."
- "AOPL would then communicate these suggestions to the Commission"

Guideline Overview

Parts of the Guideline

Introduction

- Historical background
- Objective and conceptual framework
- Amending the Guideline
- Transition approach
- Content history

Resolved Issues

- Set 1: Broad Account Classifications (4)
- Set 2: Employment Related (4)
- Set 3: General Accounting (14)
- Set 4: Instructions to FERC Form 6 (8)

Oil Pipeline Industry Accounting Guideline:

2) Review of Resolutions

Broad Account Classifications

RESOLUTION SET 1

1-01 – Carrier vs. Noncarrier Property

Define carrier property

- Carrier FERC-defined as “subject to Interstate Commerce Act”
- Would exclude intrastate-only and nonregulated assets

Resolution

- Property held for purpose of providing common carrier pipeline service shall be designated Carrier Property.

Rationale

- FERC definition of tangible property
- Form 6 instructions, page 301

1-02 – Idle Carrier Property

Classify out-of-use carrier property

Resolution

- Idle carrier property with no future use in common carrier pipeline service should be:
- Transferred at book value to Noncarrier Property, Account No. 34, or
- Retired from service if it has no useful value.

Carrier Property, Account No. 30, includes unused property if it is “held for [carrier] use within a reasonable time under a definite plan for pipeline operations”.

Idle-carrier asset with no future use planned, but as yet undisposed of: salvage value carried in either Other Current Assets, Account No. 19, or in Miscellaneous Other Assets, Account No. 43

Rationale

Careful reading of the regulations

1-03 – Operating vs. Noncarrier Revenue

Distinguish operating from noncarrier revenue

Resolution

- Rule: Asset type → Revenue type
  - Carrier property → Operating Revenue
  - Noncarrier property → Noncarrier Revenue
- Exception:
  - Disassociation w/carrier operations → Noncarrier

Rationale

- Careful examination of USoA revenue account descriptions

1-04 – O&M versus General

Distinguish Operating and Maintenance (300s) expenses from General (500s)

Resolution

- Function
- Physical location (example, field/central)
- Related-property classification

Rationale

- Language in account descriptions
- Consistency benefits:
  - Allocation of overhead among pipeline segments
  - Overall clarity of financial information

Employment Related

RESOLUTION SET 2

2-01 – Filers without Employees

Record salary and wages for a company with no employees

Resolution

- Cost-of-services provided by people outside the company should be charged as Outside Services
- Salaries and Wages only charged if the management company is under common ownership with the pipeline
- Everything else charged to Outside Services

Rationale

- Enhancement of Comparability

2-02 – Benefits of Operations Personnel

Record benefits: O&M other or benefits (general)

Resolution

- Record benefits charges in Employee Benefits, Account No. 550, for O&M and General employees.
- Exception for outside services

Rationale

- Consistent with recording of payroll taxes (Resolution 2-03)

2-03 – Payroll Taxes

Record payroll taxes – which account?

- Salaries and Wages, Account 300/500?
- Employee Benefits, Account 550?
- Pipeline Taxes, Account 580?

Resolution

- Record payroll taxes in Pipeline Taxes, Account 580.
- Exception for outside services

Rationale

- Account No. 580 includes all taxes other than income taxes.
- Page 305 of Form 6, Section B, specifically lists “Old-Age Retirement” as a kind of government tax.

2-04 – Relocation & Recruiting Expenses

Record relocation and recruiting expenses – employee benefits or general human resources?

- Employee Benefits, Account No. 550?
- Outside Services, Account No.'s 320/520?
- Other Expenses, Account No.'s 390/590?

Resolution

- Record relocation and recruiting expenses in Other Expenses, Account No.'s 390/590.

Rationale

- They are costs "not defined or classified in other accounts".

General Accounting

RESOLUTION SET 3

3-01 – Interest Payments

Record interest other than “interest expense on all classes of debt”

Resolution

- Record all interest payments in Interest Expense, Account No. 650, except those specifically excluded in the account description.
- Record other costs of debt (e.g. amortization of issuance costs) in Miscellaneous Income Charges, Account No. 660.

Rationale

- Account No. 650 description generally inclusive in tone
- Account No. 660 specifically includes “amortization of debt expense”

3-02 – Fines and Penalties

Report fines and penalties

Resolution

- Record charges for fines and penalties in Miscellaneous Income Charges, Account No. 660.

Rationale

- In general, fines and penalties are not incurred for the purpose of providing transportation service.

3-03 – Right-of-Way O&M

Record non-payroll right-of-way operations and maintenance expenses

Resolution

- Record contract labor in Outside Services, Account No. 320.
- Record materials expense in Materials and Supplies, Account No. 310.
- Record maintenance of noncarrier right-of-way in Income from Noncarrier Property, Account No. 620.

Rationale

- More descriptive presentation than the alternative, i.e., grouping it in Other Expenses, Account No. 390

3-04 – Non-Compressor Fuel

Record non-compressor fuel, such as vehicle gasoline and diesel

Resolution

- Record vehicle fuel charges in same account as related vehicle:
  - Field Vehicles – Account No. 390
  - Central Office Vehicles – Account No. 590
- Same principle applies to fuel used in aircraft, work equipment

Rationale

- USoA account descriptions specifically identify such costs as belonging in Account No.'s 390 and 590.
- Fuel used in vehicles is a cost of vehicle operation and rightly belongs in these accounts.

3-05 – Station Fuel and Power and Drag Reducing Agent

Record (1) station fuel and power and (2) drag reducing agent (DRA)

Resolution

- Record both in Fuel and Power, Account No. 330.

Rationale

- Best expression of economic reality
- Example: $1,000 spent on DRA reduces power cost 12%

	No DRA	DRA as Supplies	DRA as Power
Supplies	$2,000	$3,000	$2,000
Power	$10,000	$8,800	$9,800

3-06 – Equity in Earnings

Record equity in earnings of non-consolidated subsidiaries

Resolution

- Record in Miscellaneous Income, Account No. 640
- Maintain reconciliation of account total to Form 6 detail

Rationale

- Form 6 Income Statement provides specific lines for identification and reporting
- However, no USoA income account exists for this activity
  - Fails criteria for Interest and Dividend Income, Account No. 630, and Unusual or Infrequent Items, Account No. 645
  - Committee may ask FERC for new account added to USoA

3-07 – Committed Throughput Not Met

Record tariff charges paid to another pipeline to transport barrels that the company has committed to move but lacks capacity to do so

Resolution

- Record in Outside Services (O&M), Account No. 320

Rationale

- Character of committed-throughput-not-met explicitly stated in definition of Outside Services, Account No. 320

3-08 – Operating Oil Supply Adjustments

Record adjustments to operating oil supply

Resolution

- Record the cost of oil purchased monthly at current market price or lower of cost or market (“LCM”).

Rationale

- Provides clarification on tariff allowances and operating gains.

3-09 – Materials and Supplies

Distinguish materials and supplies O&M from general

Resolution

- Consumable materials, Operations and Maintenance, Materials, and Supplies shall be charged to Account 310.
- General, Materials and Supplies shall be charged to Account 510.

Rationale

- The Commission's definition of Materials and Supplies in the USoA and common practice align with these definitions.

3-10 – Casualty and Other Losses

Record casualty losses net of insurance receipts

Resolution

- Any expenses related to the loss or damage of oil, other commodities, property, or life resulting from fire, flood, or other casualty shall be charged to Account No. 570 – Casualty and Other Losses.

Rationale

- The Commission's definition of Casualty and Other Losses in the USoA and common practice align with these definitions.

3-11 – FERC Annual Charges

Record FERC annual charges

Resolution

- FERC annual charges shall be charged to Account No. 510 – Materials and Supplies.

Rationale

- Even though FERC charges are neither materials or supplies, 18 CFR 382.106(c) states that “any oil pipeline company… must account for annual charges paid by charging the amount to Account No. 510, Supplies and Expenses, of the Commission’s Uniform System of Accounts.”

3-12 – Other Noncurrent Liabilities

Inclusiveness of Other Noncurrent Liabilities, account 63

Resolution

- Account 63 should be inclusive of all long-term liabilities not accounted for elsewhere.

Rationale

- Instruction 2-6 (of 18 CFR 352) makes clear that the reference to “such items as…” in the description of Account 63 means all other noncurrent liabilities not recorded elsewhere.

3-13 – Equity Reporting, Non-Corporate

Report equity for non-corporate entities

Resolution

- Pass-through entities (such as MLP’s or LLCs) that have stated par value stock should report equity contributions associated with that par value in Account No. 70—Capital Stock.
- Entities that does not have a stated par value stock should report equity purchases or contributions in Account No. 73—Additional Paid-in Capital.
- Current Period Earnings should be reported under Appropriated Retained Income, Account No. 74, or Unappropriated Retained Income, Account No. 75
- Dividends or distributions should be reported under Unappropriated Retained Income, Account No. 75
- Acquisition of partnership units or stock that is neither retired or cancelled should be reported under Treasury Stock, Account No. 76
- The portion of net income attributable to non-controlling interests should be reported in account 660 of the Income Statement—Miscellaneous Income Charges.

Rationale

- Reporting equity this way is consistent with prescribed GAAP accounting and is appropriate due to a lack of guidance on equity reporting of non-corporate entities.

3-14 – SCADA and Operations-control Expenses

Record Supervisory Control and Data Acquisition (“SCADA”) and Operations Control (scheduling and dispatching) group expenses

Resolution

- Record expenses generated by SCADA and operations control groups as Operating and Maintenance expenses including: scheduling, dispatching, and supervisory control and data acquisition (SCADA) systems.

Rationale

- USoA defines operations and maintenance expense to include “all costs directly associated with scheduling, dispatching, movement, and delivery” of crude oil or products.

3-15 – Asset Held for Sale

Held-for-Sale status of carrier assets does not accounting.

Resolution

- Continue to record balances of carrier assets held for sale in account 30, Carrier Property (still in service), and account 34, Noncarrier Property (when no longer in service).
- Depreciation follows the asset classification.

Rationale

- The classification of long-lived assets as carrier vs. noncarrier property is of central importance to filer and users of regulatory accounting information.

3-16 – Deferred Tax Assets and Liabilities

Resolution

- The deferred-income-tax balance-sheet accounts should not be netted. They present balances that are distinct in character.

Example

- Current
  - Employee benefits (19-5) **$ 1,500**
  - Prepaid expenses (59) **$(500)**
- Noncurrent
  - Depreciation (64) **$(5,000)**
  - Dismantlement (45) **$ 3,000**

	FERC Account	WRONG	CORRECT
Assets			
Deferred income tax assets (current)	19-5	$1,000	$1,500
Accumulated deferred income tax assets (non-current)	45	$0	$500
Liabilities			
Deferred income tax liabilities (current)	59	$0	$5,000
Accumulated deferred income tax liabilities (non-current)	64	$2,000	$3,000

3-17 – Accounting for Investments in Subsidiaries

How should a respondent company account for and report a majority investment in another company? Should consolidation method or equity method of accounting be used?

Resolution

- The equity method should be used in all cases where GAAP treatment would require the use of either the equity or consolidation methods.
- Exception: If the respondent applies for and receives Commission approval for alternative accounting treatment (Rare).

Rationale

- The Form 6 is not deemed to be a GAAP driven presentation from a consolidation standpoint, but rather a stand-alone presentation of its carrier activities.
- Resolves any complications if a subsidiary also has Form 6 reporting responsibilities, i.e., duplicative information filed with the FERC.
- Avoids inclusion of financial and statistical information of an entity not subject to the Interstate Commerce Act.
- **TIP: The Form 6 respondent should avoid owning subsidiaries if at all practical**.

Form 6 Reporting

RESOLUTION SET 4

4-01 – Product Number and Name

In Form 6, pages 600-601, Statistics of Operations requires that the filer to disclose volume by origin and product type. Should a filer include both the product number and the product name in this section? What product code should be used for transmix? What is the meaning of "n.e.c."?

Resolution

- The state of origin for volume received should be included for commodity codes 29111-29117.
  - For products not explicitly classified ("n.e.c."), filers should use commodity code 29119, Products of Petroleum Refining, n.e.c.
- Follow formatting convention
  - TX 29111, Gasoline, jet fuels
  - OK 29119, Transmix

Rationale

- The Committee determined that listing both a product name and commodity code most accurately follows the instructions on Page 600 for commodity code 29119

4-02 – Long-term Debt and Interest Reporting

On page 227 of the Form 6, Long Term Debt, item 7of the instructions suggests that the reference to interest “paid to the respondent” actually means interest that the filer (respondent) pays on the debt it has issued, not the interest it receives from holding the debt of another company or government.

Resolution

- Filers should assume that the instructions intend to require respondents to record interest that the filer pays on the debt it has issued.

Rationale

- The long-term debt held by a company would involve interest expense paid *by* the filing entity. The wording of the instructions implies that the company would pay interest to itself, which is incorrect.

4-03 – Mileage Disclosure for Pipeline Not Operated by Filer (Page 602)

Page 602 of the Form 6, Miles of Pipeline Operated at the End of the Year, includes only pipelines “operated by respondent”. What exactly does this entail?

Resolution

- Page 602 statistics should include all respondent pipeline mileage including (1) all pipelines operated by the respondent and (2) pipelines of an undivided joint interest (“UJI”) of the respondent that are operated by others.
- Pipelines not operated by the respondent should not be reported on Page 602 unless associated with a UJI.

Rationale

- The resolution to report mileage on page 602 for all pipelines operated is consistent with the instructions in Form 6.

4-04 – Payments for Services Rendered by Other than Employees (Page 351)

What payments should be reported on this page?

Resolution

Exclude the following; report the rest

- Aggregate payments less than $100,000
- Items mentioned in (3.) of the instructions
  - Rent, taxes, utilities, tariff charges
  - **Items ordinarily connected with the routine operation, maintenance, or construction of a pipeline.**
  - **Do not include any special and unusual payments for services**

Rationale

Careful reading of instructions

4-05 – Volumes Included in Statistics of Operations (pages 600 and 601)

Inclusion of non-revenue and non-FERC barrels in statistics reported

Resolution

All physically metered volumes should be reported

- Inter- and intra-state
- Revenue and non-revenue generating (transmix)

Rationale

Careful reading of instructions

4-06 – Mileage of Loop Lines in Miles of Pipeline Operated (Pages 602 and 603)

Inclusion of loop (parallel) line in mileage statistics reported

Resolution

Loop lines should be reported as separate lines according to their separate diameters

Rationale

Careful reading of instructions; consistency with Guideline Resolution 4-03

4-07 – Descriptions for Miles of Pipeline Operated (Page 602)

Convention for clear descriptions in mileage statistics

Resolution

Report pipeline name and state appropriately for each section (A–D) of the report, following the detailed recommendations of this resolution (*see* Guideline)

- ABC Pipeline Company – TX
  - TX (diameter, miles)
  - TX (diameter, miles)
- Postal abbreviations for states
- Footnotes when field length runs out
- Refer to footnote used again (rather than repeating it)

Rationale

Careful reading of instructions

4-08 – Statistics-of-operations Categories (Pages 600 and 601)

Explanations of column headings for volume statistics

Resolution

Follow clarifications provided

- Suggested definition of gathering versus trunk: meters, tanks, or manifolds as boundary
- Connecting carriers defined by FERC tariff on file
- Movements from one tank to another, not reported

Rationale

Collective interpretation consistent with instructions

4-09 – Initial Filing of Form 6 and Form 6-Q

When should a newly formed regulated oil pipeline company file its initial Form 6 and its initial Form 6-Q?

Resolution

- Initial Form 6 should be filed in the calendar year the company begins carrier service.
- Initial Form 6-Q should be filed upon completion of its first full calendar **quarter** of carrier service.
- Subject to the thresholds of projected operating interstate revenues set forth in 18 CFR 357.2.

Rationale

- Follows the apparent intent of 18 CFR 375.2 and 357.4 requiring annual and quarterly filing for companies subject to Part I of Section 20 of the Interstate Commerce Act.
- Consistent with informal direction given other carriers in the past.

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