INTERNATIONAL ASSOCIATION OF DRILLING CONTRACTORS

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Technical Director
Financial Accounting Standards Board
401 Merritt 7
Post Office Box 5116
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Dear Technical Director:

We acknowledge the need for improved financial accounting and reporting standards for leases and appreciate this opportunity to respond to the FASB exposure draft for the accounting standards update to Topic 840, *Leases*.

International Association of Drilling Contractors
The International Association of Drilling Contractors (the "IADC") is dedicated to enhancing the interests of the oil-and-gas and geothermal drilling and completion industry worldwide. Membership is open to any company involved in oil and gas exploration, drilling or production, well servicing, oilfield manufacturing or other rig-site services. IADC's contract drilling members own most of the world's land and offshore drilling units and drill the vast majority of the wells that produce the planet's oil and gas. IADC's membership also includes oil-and-gas producers, and manufacturers and suppliers of oilfield equipment and services.

Founded in 1940, IADC's mission is to improve industry health, safety and environmental practices; advance drilling and completion technology; and provide for safe, efficient and environmentally sound drilling operations worldwide. Through conferences, training seminars, print and electronic publications, and a comprehensive network of technical publications, IADC continually fosters education and communication within the upstream petroleum industry.

Contract Drilling Services
Industry participants generally contract their drilling units, related equipment and work crews primarily on a market-driven dayrate basis to drill oil and gas wells for customers. Under the drilling contract, the contractors are responsible for the operation of, access to and safety of the rig and rig equipment. The customers are generally responsible for the development of the drilling programs and direction of the drilling operations. Drilling contracts generally name a drilling unit that will be used in performing our services. Under certain circumstances, a named drilling unit may be substituted with another similarly equipped drilling unit. Even though such substitution generally requires a contractual amendment, it is not generally denied. The fee structure for drilling contracts is generally based on defined dayrates that

are contingent upon certain conditions and provide for additional revenue-earning opportunities based on contract terms. The drilling contract may be structured for short-term or long-term periods.

Under existing accounting standards, contract drilling revenues are recognized as earned under a service contract model. Operating revenues from contract preparation or capital upgrades are recognized on a straight-line basis over the estimated firm period of drilling, consistent with the general level of activity and services provided.

Proposed Lease Accounting Model

We note that the Board's primary criticism of the existing standard is its failure to meet the needs of users of financial statements because they do not provide a faithful representation of leasing transactions. The Board further states that "the existing models lead to a lack of comparability and undue complexity because of the sharp 'bright-line' distinction between capital leases and operating leases." Although some have questioned whether our drilling contracts have historically been considered to contain a lease component, as an industry, industry participants agree that the accounting under the existing standards, whether or not lease accounting was applied, is materially similar and would not alter the recognition model that is currently, consistently applied within the industry. Under the proposed standards, however, this may not continue to be the case.

As it relates to our industry, we believe that the Board has not achieved the objectives they have set forth to accomplish. We believe that the proposed standards will lead to a lack of comparability and undue complexity for a variety of reasons.

First, the proposed standards involve a great deal of subjectivity and uncertainty, especially with regard to lease term and lease payments. Drilling contracts frequently contain options to extend and contingent payments, which may be incorporated into the revenue recognition associated with the lease component, if our drilling contracts are determined to contain a lease component. For each drilling unit, the preparer may be required to prepare assumptions related to (a) the bifurcation of the service and lease component, (b) future lease term, (c) future lease payments, (d) depreciation approach, among others. The judgment and estimates that may be required to apply these proposed standards will likely reduce the comparability of revenues among the industry participants and among rigs within their fleets.

Second, our industry participants generally publish a periodic fleet or rig status report that contains the operating dayrates for the rigs in the fleet. Assuming we are required to bifurcate the contract into a lease component and service component, under the proposed standards, the dayrate would no longer have a direct relationship with the reported revenues. As a result, our industry participants may be required to increase the amount of discussion and analysis in their public filings, potentially with a number of non-GAAP reconciliations, to offer the users of the financial statements the same information that is easily communicated under current standards. This results in added complexity for the users of the financial statements.

Third, considering the judgments and estimates involved and the reassessment requirements for each of those assumptions, preparers of the financial statements may be required to reevaluate lease revenues, assets and liabilities on a quarterly basis. The number of assumptions required by the standard will make it challenging for preparers to establish a process that can be reperformed by more than one employee in a consistent fashion and that is auditable. Since the operational management of our industry participants does not manage the businesses in this manner, accounting departments will likely be required to prepare internal reports that deviate from the external reports that may be required by the proposed standards. These additional reports and the reassessment requirements will likely increase the amount of work and challenge the preparers' abilities to produce accurate and timely financial statements. This will result in undue complexity and additional burden for the preparers of the financial statements.

Conclusion

Accordingly, we do not believe that the proposed accounting standards update achieves the stated objectives for modifying the lease accounting model. Furthermore, if it is determined that the proposed accounting standards apply to drilling contracts for the contract drilling services industry, we believe that the proposed accounting standards will result in a lack of comparability and undue complexity that is significantly beyond that of the current standards.

Respectfully,

IADC
Accounting Issues/Procedures Committee