Dear Board Members:

Thank you for the opportunity to respond to the Financial Accounting Standards Board’s (FASB) Exposure Draft (ED) on leases. We acknowledge the need for improved financial accounting related to leases particularly with respect to the Board’s primary objective of reflecting material lease liabilities on the balance sheet, however we do not believe the lessor model as proposed by the ED is an improvement to current lessor accounting.

We analyze the international offshore drilling industry, which drills and completes exploratory and developmental oil and gas wells, and as such are users of the financial statements of companies in the industry. Drilling contracts generally provide for the completion of an offshore well and lay out specifications with respect to the drilling rig and equipment that will be used in order to complete the well, timing, personnel, and the rate structure. Drilling company customers are billed a daily rate which can vary based on the efficiency of the rig’s operations and includes everything needed to complete the well (i.e. personnel, equipment, insurance etc.). These contracts may be short term or long term (greater than 12 months) and may have options to extend.

In our opinion, the proposed model for determining lease assets and liabilities, both from the perspective of a lessee and a lessor, is overly complex and does not meet the Board’s stated objective of creating more transparency, consistency, and comparability of financial statements.

If adopted as currently written, one significant adjustment made in analyzing the financial statements would be to reverse the impacts of recording a lease receivable and front loading income for arrangements that may contain leases and apply the model used now – accrue as service is performed and equipment is used which is more closely aligned with cash flow and progress under contracts. The measurement provisions in the ED regarding lease term and contingent rentals drive this belief. Assets and liabilities should not be recorded based on probability weighted expected amounts or based on events that have not yet occurred with respect to renewal options. We believe the current operating lease model where income is recognized on a straight line basis over the lease term and contingent rentals are recognized when they are earned is more in line with the cash flows of the transaction, how the asset is used, and how the service is being performed.

The timing and amounts received under drilling contracts are dependent on many factors that are at times outside of the drilling company’s control and cannot be reasonably predicted, i.e. environmental factors including weather and underground conditions, equipment failure, international conditions. Therefore, we do not believe that the model should allow for the front loading of revenue when the receivable recorded is based on a weighted average probability of amounts to be received in the future. We also believe the estimation of lease terms and contingent rentals will reduce comparability in financial reporting between industry participants.

Drilling companies provide a service as opposed to being a lessor of assets, and the users of drilling company financial statements view the revenues as service revenue. The daily rate that is charged includes multiple elements including personnel, maintenance and repairs, insurance, taxes, and transportation of the rig to and from the well site.
Contract prices are based on market rates and do not price or offer each component individually. We do not think it is appropriate to divide these elements and treat part of the contract as a lease as this is not reflective of the substance of the transaction or understanding of the contracting parties. We think a lack of clarity for determining when an arrangement contains a lease will lead to diversity in practice resulting in a lack of comparability from a balance sheet and income statement perspective.

In our opinion, the cost of implementing the standard and maintaining the lease assets and liabilities over the life of the lease outweighs the benefits achieved. Per discussion with drilling companies' management, the implementation of this standard would be purely for compliance with external financial reporting requirements as management reporting used for decision making would continue to be based on the current accounting model. Also, as a user of the financial statements we would need to make adjustments to the financial statements under the proposed model to better reflect income earned on drilling contracts. Under the ED, the creation of non-GAAP measures to reconcile the underlying economic transaction to the new accounting rules will burden resources with little benefit.

Med venlig hilsen/
Yours sincerely

First Securities ASA

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