EITF ABSTRACTS

Issue No. 90-22

Title: Accounting for Gas-Balancing Arrangements

Dates Discussed: November 8, 1990; January 10, 1991

Reference:
FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities
FASB Statement No. 161, Disclosures About Derivative Instruments and Hedging Activities

ISSUE

Companies A and B are partners in a gas well. During the current period, Company B may decide not to sell any gas because it does not have a purchaser or because market conditions are unfavorable. Accordingly, Company A (the overtaker) agrees to take all the gas production for the period and sells it to its customer. In the future, Company B has the right to take more gas than its interest would otherwise allow to make up for Company A's overtake. Alternatively, Company A may make payment in kind (using gas from a different well) or pay cash to Company B.

The issue is how to account for this "gas-balancing" arrangement.

Under the "entitlements method," each unit of gas is assumed to be jointly owned by the partners in the well. When Company A sells units of gas, it recognizes sales revenue only to the extent of its proportionate share of the gas sold and records a payable to Company B. Likewise, assuming Company B also follows the entitlements method, it recognizes a receivable from Company A and sales revenue for its proportionate share of the gas sold by Company A. Under the "sales method," Company A recognizes sales revenue on all gas sold to its customers notwithstanding the fact that Company A's ownership is less than 100 percent of the gas sold. It is understood that Company B will sell more than its share in some future period. Company A reports no payable to Company B. Under the sales method, Company B reports no revenue or receivable. Both companies may record
memo entries to monitor the imbalance. In all situations, Company B may or may not follow the same accounting method as Company A.

**EITF DISCUSSION**

The Task Force noted that diversity in practice exists in accounting for gas-balancing arrangements. However, because of the industry-specific nature of the issue, and the existence of established practice, the Task Force agreed to refer the issue to the appropriate industry group of the AICPA for possible consideration. [Note: See STATUS section.]

The SEC Staff Observer stated that the SEC staff has not taken a position on which method is preferable. The SEC Observer also stated that a receivable or liability recorded using the entitlements method should be valued at the lower of (1) the price in effect at the time of production, (2) the current market value, or (3) if a contract is in hand, the contract price. Receivables should be net of selling expenses. SEC registrants should disclose their method of accounting, as well as the amount of any imbalance in terms of units and value, if significant. Registrants should also disclose in Management's Discussion and Analysis the effect of gas imbalances on operations and on liquidity and capital resources.

The SEC Staff Observer further noted that registrants should account for all significant gas imbalances consistently, using one accounting method. If the sales method is used by the overtaker and reserves are insufficient to offset the imbalance, the overtaker should record a liability for the amount of shortfall in reserves valued at current market price unless a different price is specified in the contract in which case the contract price may be used.
STATUS

Statement 133 was issued in June 1998 and has been subsequently amended. The effective date for Statement 133, as amended, is for all fiscal quarters of all fiscal years beginning after June 15, 2000.

The terms of the gas-balancing arrangement should be analyzed to determine whether it meets the definition of a derivative under Statement 133. In particular, the option in the agreement may not meet criterion 6(a) (as further clarified by the guidance in Statement 133 Implementation Issue No. A6, “Notional Amounts of Commodity Contracts”) with respect to a notional amount, even though it may meet criterion 6(c), as discussed in paragraph 9, in part because the gas is readily convertible to cash. Even if the gas-balancing arrangement meets the definition of a derivative, the cash price used in settlement may result in the derivative always having a fair value of zero. Nevertheless, the disclosures specified in paragraphs 44, 44A–44E, 45, and 45A of Statement 133 would still be required. The option feature of the agreement, if it meets the definition of a derivative, could not qualify for the normal purchases and normal sales exception in paragraph 10(b) because the “gas-balancing” arrangement is an option contract and it is not probable at inception and throughout the term of the arrangement that the contract will not always settle net and will always result in physical delivery.

Statement 161, which was issued in March 2008, amended Statement 133 to require entities to provide enhanced disclosures about derivative instruments and hedging activities to enable investors to better understand their effects on an entity’s financial position, financial performance, and cash flows.

No further EITF discussion is planned.
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