FINANSTILSYNET
THE FINANCIAL SUPERVISORY
AUTHORITY OF NORWAY

Letter to Statoil ASA dated 10 March 2014

Appendix A

1. Value in use for impairment purposes – Practice of using reliability intervals

1.1 Introduction

When testing assets for impairment by calculating the value in use ("VIU"), Statoil has applied a reliability interval around the company's initial value in use estimate. A thorough evaluation was performed by Statoil before the principle was introduced in 2009.

For the purpose of providing practical guidance, the detailed accounting assessment was then operationalized in the group accounting manual. The following statistical rationale for the existence of reliability intervals there presented, is shared by Statoil:

> *"If the probability distribution is not known, deviates from a normal distribution or there is a purely subjective view of the probability distribution, it should be considered whether there is an applicable range rather than a reliable point estimate."...*

Within the range all estimates are assumed to have the same likelihood of occurring. The interval will depend on the uncertainty deemed to be present, and will range from a minimum of 15 % up to 30 % on both sides of the initial estimate. With a 30% reliability interval, the principle may lead to no impairment being recognized in a situation where the book value on an asset is 130 and the initial point estimate for value in use is 100. The reliability interval will in this instance be defined as 70 to 130 – where all estimates in between the two are regarded as equally probable. However, if the point estimate value in use is reduced to 99 in the next period, an impairment of 31 will be booked.

Statoil has emphasized that:

> "*the use of an interval of reliable estimates is not a materiality assessment and that not recognizing an impairment write-down or reversal of a previous impairment write down to the calculated point estimate in each specific case is not akin to having a known error in the accounts*."

Statoil has further underlined that the evaluation of impairment indicators is a separate process, preceding the actual impairment test and that the reliability interval principle has no indirect effect of whether impairment tests are actually performed. Finanstilsynet has noted this.

1.2 Statoil's evaluation

In its letter of 27 January 2014, Statoil has described the principle as follows:

"The application of the methodology is a 4-stage process:

1. *Establish an initial estimate to calculate an interval of possible Value in Use estimates (all estimation uncertainty reflected in either cash flow or discount rate in accordance with IAS 36.32)*
2. *Calculate interval of possible best estimates of Value in Use*
3. *If interval below book value, determine fair value less costs to sell*
   a. *Obtain market price of asset quoted in active market if available*
   b. *In the cases where multiple valuation techniques are appropriate, the fair value measurement is the point within the range that is the most representative of fair value in the circumstances in accordance with IFRS 13.63*
4. *Determine the best estimate of an un-biased value of the non-financial asset (this is defined as a single number)."*

When calculating an asset's value in use as part of testing assets for impairment, Statoil first establishes an initial estimate of the asset's net present value where "*all estimation uncertainty is reflected in either cash flow or discount rate in accordance with IAS 36.32*" (stage one). After this, and as set out in Statoil's accounting manual, an interval of best estimates of value in use is set around the initial estimate (stage two). The interval will depend on the uncertainty deemed to be present, and will range from a minimum of 15 % up to 30 % on both sides of the initial estimate. As long as the book value of an asset is within the interval, Statoil will not record an impairment loss (even if the mid-point of the interval is below the book value).

As described, in the 27 January letter, Statoil informed that in addition to the descriptions in the group accounting manual, the full application of the methodology includes two more stages. If the highest value within the interval is below the book value, Statoil will seek to determine the asset's fair value less cost to sell and apply this as recoverable amount (stage three). Statoil will lastly determine the best estimate of an unbiased value of the non-financial asset and this is defined as a single number (stage four). If the highest value within the interval is below the book value, and it is not possible to determine the fair value less cost to sell, Statoil will book an impairment loss and write down the asset to the mid-point of the interval, i.e. the initial point estimate.

Stage four of Statoil's process is described as follows:

> *"In stage 4 of the process, the methodology requires that the best estimate of the value in use in determined as a single point estimate. Statoil believes that within the defined interval all outcomes are equally probable and there is no point within the interval that is identifiable as the best estimate of the value in use. However, if the book value of the asset or CGU being*

> *tested is outside the mid-point (the initial point estimate) is as a practical application used as the value to which the asset/CGU is written down…"*

Within the interval applied in the specific impairment test, Statoil views that every individual estimate is just as likely.

Statoil has explained that the introduction of an accounting practice applying reliability intervals was based on some fundamental views related to economic realities, an assessment of requirements in IAS 36 and IFRS guidance that require the use of professional judgment.

Statoil's views on fundamental economic realities give two important assumptions for the valuation of non-financial asset. Firstly there is significant uncertainty around the expectation for parameters in the valuation of assets in the oil and gas industry. Second, the probability distribution for key parameters such as reserves and oil prices are assessed to be unknown. According to Statoil, "*the impact on the valuation of non-financial assets from these two assumptions is that the uncertainty in expectations is not possible to directly reflect mathematically in a net present value model.*"

According to Statoil's assessment, IAS 36 assumes that the probability distribution is known. Because the distribution is in fact unknown, Statoil's view is that professional judgment must be exercised. Statoil holds that:

> "*There is no requirement in IAS 36 to calculate a point estimate. The requirement is to calculate a value in use.*"

In the letter of 27 January 2014, Statoil further writes "*On the contrary, in the basis for conclusions in IAS 36 (IAS 36. BCZ40-42) the IASB (IASC at the time) specifically discusses and concludes not to restrict the options for alternative outcomes to one point estimate…"*

In describing the requirement to apply professional judgment, Statoil has referred to:

- Guidance found in IAS 8.32 and 33, as well as the IFRS Framework's qualitative characteristics of useful financial information.
- Articles regarding advice on professional judgment issued by an advisory committee to the US Securities and Exchange Commission ("SEC").

More specifically on the need for professional judgment in estimating recoverable amounts, Statoil writes that this has "*been acknowledged by the IASB throughout IAS 36, particularly in IAS 36.23 and IAS 36 Appendix A (e.g. A6 and A17)*"

Based on the above, Statoil has exercised its professional judgment to reflect the uncertainty in expectations. In Statoil's view, no uniform model is capable of addressing the uncertainty given by an unknown probability distribution. This again leads to more than one estimate having the properties of best estimate. This resulted in the principle of an interval of reliable estimates.

Statoil has stated that the use of an interval of reliable estimates is within an acceptable and faithful management judgment allowed by IFRS. The principles has been consistently applied and documented.

Lastly, Statoil has underlined that a thorough evaluation was carried out when the principle was introduced in 2009, and that both its former and current external auditor:

> *"...support the conclusions made in light of the Financial Statement as a whole."*

1.3 Finanstilsynet's evaluation

Finanstilsynet agrees with Statoil that VIU estimates are inherently uncertain. The accounting estimate generated by using the rules in IAS 36 will in practice not be identical to the actual outcome. Finanstilsynet believes that consistent application of the rules in IAS 36 to generate a single estimate, coupled with disclosures on inputs used and sensitivities in estimates will result in the necessary predictability, transparency and comparability between financial statements prepared by issuers.

In Finanstilsynet's view, the economic uncertainties that Statoil faces when calculating value in use are not very dissimilar to that of other issuers. Estimations of value made by most issuers will be based on assumptions that are uncertain. This uncertainty shall according to IAS 36 be reflected when impairment tests are performed.

Finanstilsynet does not concur with Statoil's evaluation that the guidance in IAS 36 only relates to situations where the probability distribution is known. Finanstilsynet further finds that the paragraphs in the Basis for Conclusion mentioned by Statoil, relate to the basis for cash flow projections and cannot be interpreted as allowing a range in the value in use estimates themselves.

According to IAS 36.32, uncertainty in determining an asset's value in use should be reflected in one of two ways; either as adjustments to the future cash flows or the discount rate. Statoil makes considerable effort when estimating the future cash flows that represent management's best estimate. Finanstilsynet has been informed that the process includes a detailed macro analysis and analysis of assumptions. As is required in IAS 36.30b, uncertainties regarding both amount and timing in cash flows are taken into account by Statoil during this process. In Finanstilsynet's opinion, Statoil's initial value in use estimate is a value in use estimate in accordance with IAS 36.

While the application of a range concept is clearly evident in IAS 36 guidance relating to the estimation of cash flows or discount rates, Finanstilsynet finds the contrary to be the case in relation to the actual resulting net present value estimate constituting the value in use:

- On ranges in cash flows etc.: "*Estimated cash flows or discount rates should reflect the range of possible outcomes rather than a single most likely, minimum or maximum possible amount*", cf. IAS 36.A3c.

- On the singular value in use estimate: Whichever approach an entity adopts to reflect expectations about possible uncertainties and variations, the result of the computation should be the "*weighted average*" of all possible outcomes, cf. IAS 36.32 and IAS 36.A2

"Weighted average" is a statistical term that in Finanstilsynet's view can only be interpreted as a number and not an interval. Finanstilsynet is consequently of the clear opinion that IAS 36.32 requires the value in use to be estimated as a singular estimate (point estimate) and not an interval. Finanstilsynet believes this to be consistent with widespread IFRS practice. If the book value of an asset falls below the estimated value in use, an issuer shall according record an impairment loss, cf. IAS 36.59.

In describing stage four of the process, Statoil makes it clear that besides in cases were impairments are made, the specific point estimate within the interval actually employed in the impairment test is not identified. [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……]

Since no impairment is booked in situations where the book value is close to the upper limits of the interval, a possible understanding is that Statoil in fact is employing a VIU point estimate in the uppermost part of the interval. However, this would then illustrate a statistical inconsistency in Statoil's accounting practice. The reason being, that only a small subsequent change in assumptions will cause Statoil to write down, measured not by using the point estimate in the high end of the interval but rather the centrally weighted initial value in use.

Statoil's initial VIU point estimates apply discount rates and commodity prices etc., that are used consistently across assets tested for impairment and in line with any disclosures of assumption in the financial statements. Finanstilsynet finds that this will not be the case for the key inputs and assumptions that would be associated with any other point estimate within the interval.

Finanstilsynet agrees that the application of professional judgment is a key factor, both in preparing financial statements in general and particularly relating to accounting estimates. However, Finanstilsynet does not see that the arguments presented by Statoil, underpin the reliability interval practice to a significant degree. Finanstilsynet does not disagree with Statoil's argument that in developing a professional judgment it is often relevant to keep track of the ongoing discussions within the accounting community. However, many of such discussions/articles have their origin in a critique against the existing accounting rules rather than shedding light on its implications. Hence, use of articles as a guide when developing practice under current IFRS must be done with caution.

In Finanstilsynet's opinion Statoil's application of a reliability interval in calculating value in use for impairment testing purposes, is not in accordance with IAS 36. In letter of 28 February 2014, Statoil states that it will end the use of reliability intervals under future accounting practices and correct errors made in accordance with IAS 8.

Statement from the Expert Panel - The use of an interval of reliable estimates in calculation value in use

The Expert Panel unanimously agreed the following statement:

When conducting impairment tests based on value in use, Statoil uses a two-stage procedure. First, the value in use, a point estimate, is calculated; next, a (reliability) range is constructed around the point estimate (Statoil Accounting Manual, chapter 6.2.6). Statoil does not recognize an impairment loss as long as book value is within the defined range. The Expert Panel cannot see that there is any basis for this two-stage procedure in the relevant accounting standard (IAS 36). “An impairment loss is the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount (IAS 36.6).” The recoverable amount is in this case value in use, which is a point estimate (IAS 36.30-43, in particular 36.32, as well as IAS 36 appendix A). Estimating value in use involves professional judgment and may be subject to considerable uncertainty. IAS 1.125-133 requires separate disclosures about estimation uncertainty.

Appendix B

1. Identifying the Cash Generating Unit – the Marcellus Shale Play

1.1 Introduction

Impairment tests are in general sensitive to the level at which assets or groups of asset are identified as CGUs. Incorrect identification of a CGU at a too high level may result in assets generating significant cash inflows erroneously being grouped with assets that are not. This may in turn lead to write-downs not being carried out.

As disclosed in the 2012 annual report, Statoil regards each unconventional onshore play to be a separate CGU. For the major part, the unconventional onshore plays in question relate to Statoil's investments in the US shale plays Bakken, Eagle Ford, Marcellus and the Canadian Oilsands. [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……]

Finanstilsynet's work related to Statoil's CGU definition of onshore shale plays has focused on the assets in the Marcellus shale play. There are several reasons for this, but first and foremost because impairment indicators were present requiring an impairment test to be performed in 2012. Although the focus of the review has been Statoil's CGU identification for the Marcellus assets, several of the arguments set forth may also be relevant when identifying CGUs for other unconventional plays.

Statoil's Marcellus acreage has been acquired through separate acquisitions in 2008, 2010 and 2012. The entire Marcellus Shale Play has consistently been regarded as one CGU, but Statoil has informed Finanstilsynet that the evaluation of "largely independent cash inflows" can change as the unconventional asset is developed. This may lead to more CGUs being identified in the future.

In Finanstilsynet's opinion, the identification of Statoil's assets in the entire Marcellus Shale play as one CGU is not in accordance with requirements in IAS 36. CGUs need to be identified at a lower level, using the guidance in the standard prescribing a bottom-up analysis. IAS 36 does not focus on when and how the assets were acquired. Simply splitting the Marcellus CGU along the lines of the above mentioned historic transactions acquiring the acreage without further consideration, would hence not be regarded a fair application

It is emphasized that the error in IFRS application identified by Finanstilsynet only pertains to assets within the scope of IAS 16 or IAS 38 that have to adhere to the impairment rules in IAS 36. Statoil has informed that somewhat in excess of 60% of the carrying value of the Marcellus shale play is recognized and presented as "property, plant and equipment" in Statoil's 2012 annual report. This is primarily producing assets in the form of capitalized well completion costs. The remaining 40% is recognized and presented in the balance sheet line "intangible assets. The latter includes exploration and evaluation assets that are governed by IFRS 6 *"Exploration for and Evaluation of Mineral Resources"*. IFRS 6 has rules that deviate from those found in IAS 36, both for evaluation of impairment indicators and for identification of CGUs.

According to IAS 36.6, a CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash generating unit involves judgment, and is the result of a bottom-up process, cf. IAS 36.68. According to IAS 36.69, as part of this process an entity also considers various factors including how management monitors the entity's operations or how management makes decisions about continuing or disposing of the entity's assets and operations.

Finanstilsynet and Statoil seem to be in agreement that two aspects are useful in identifying CGUs according to IAS 36. First, revenue separation - are the streams of revenue derived from the assets or groups of assets independent of one another? Second, asset separation - are assets operated together to such an extent that they do not generate independent revenue streams?

1.1.1 Background

Together with its joint venture partner Chesapeake, Statoil holds tens of thousands of leases covering approximately 8.000 km^2, diversely spread across the 250.000 km^2 area. This makes Statoil among the top Marcellus leaseholders. While other leaseholders in the Marcellus typically have a more geographically focused license portfolio, Statoil is significantly represented in Pennsylvania, New York, West Virginia and Ohio. Because of the depressed natural gas prices in the US, the development of Marcellus has in general been focused on sweet spots in a predominantly dry gas northern production area in North East Pennsylvania, and a more wet gas rich area in South West Pennsylvania/West Virginia/Ohio. However, production wells are drilled also in other areas, in part to avoid licenses from expiring (held by production). By year-end 2012, Statoil had participated in the drilling of more than 800 wells on its Marcellus licenses. In Q4-2012, Statoil's share of the daily production from Marcellus was 75.000 barrels of oil equivalents per day, constituting somewhat in excess of 10% of Statoil's daily production outside Norway.

In 2008, Statoil and Chesapeake stated that they expected between 13.500 and 17.000 wells needed to be drilled over the next 20 years to produce the reserves on the initial acreage position then acquired by Statoil. In many ways, Marcellus is hence an immature asset in the early phases of development. [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……] This has at least two implications. Firstly, as the different areas of the play are developed, the Marcellus shale play will not mature as one, but rather at all times contain areas in various degrees of maturity (increase/decline). Secondly, a significant number of new wells have to be drilled at any time to maintain overall production levels.

A shale play is defined as an area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same geological structural feature and/or stratigraphic feature. Statoil has stated that its geologists view Marcellus as a homogenous play with no significant geological differences, and that the shale is productive all across the Marcellus shale. Although the unconventional Marcellus shale play is a continuous formation, it is not homogeneous. This is illustrated by the way the US Energy Information Agency ("EIA") estimates the resources in Marcellus. The EIA has identified eight individually assessed plays (labeled "distinct plays") within Marcellus, that each has been partitioned to capture differences in geologic and reservoir conditions and in projected performance[1].

1.2 Statoil's evaluation

The Marcellus asset is in the early stages of its development. Being an undeveloped asset, it is appropriate to view the shale play as constituting one CGU. In the future, once the area has sufficiently matured, splitting the area into more CGUs may be appropriate.

Revenue separation

Statoil's starting argument from a bottom-up perspective is that a well does not generate individual cash flows that are largely independent of that of another well because the output will flow through a gathering system, processing system and a storage facility before being available for sale and being capable of generating cash inflows.

Asset separation - operations, markets and infrastructure

Statoil's key argument is that Marcellus from an operational standpoint is viewed and managed as a single business unit. The Marcellus is not necessarily identifiable by county or other similar description, although this is used to describe where certain play characteristics may be.
In the strategy, business plans and decisions Marcellus is considered one cohesive asset. There is one Marcellus asset manager in Statoil, and no segregation is made in the Marcellus team on geographical basis. On this basis, Marcellus is viewed and managed as a single business unit and investment decisions are made based on the entire field, not different areas/wells. Decisions to divest smaller non-core areas are a result of economic evaluations of the entire play.

Cash inflows in the short and long term are highly dependent on how funding is allocated to the asset as a whole and subsequently, based on continuous economic planning, attributed to the highest value acreages of the play at any given points in time. Economic recovery of assets/areas is primarily driven by price developments. Therefore, cash inflows are directly dependent on management's decision for where the contracted drilling rigs are directed to drill production wells.

The way production is managed and prioritized transported to different markets create interdependencies. Transportation assets are shared in the Marcellus. The pipeline infrastructure is such that the products are moved around easily, with no fixed market for any production from an area. This process of inter-connection is continuous and across the entire play. The intrastate and interstate pipeline systems are so interconnected that it is not feasible to directly conclude that certain systems are isolated from others, in particular in a CGU discussion perspective.

Output markets are continuously assessed for the entire play considering the infrastructure possibilities that are available. There were spot markets for dry gas within the Marcellus shale at

[1] EIA 2013 report: Technically recoverable shale oil and gas resources, pages 45 and 46

year end 2012 with some liquidity. However, the pricing in the US gas markets at year-end 2012 showed price differentials significantly larger than the reflection of transport costs.

Lastly, Statoil points out that to view each shale play as one CGU is consistent with industry practice. Although industry practice does not serve as a primary argument when determining or applying accounting policies, it provides Statoil with a comparable basis for testing the reasonableness and appropriateness of its own accounting judgments in the application of IAS 36.

1.3 Finanstilsynet's evaluation

<u>Revenue separation</u>
A bottom-up analysis starts with the singular well rather than the singular license. For conventional resources industry practice is, however, not to view the singular well, but rather the "field" as the CGU for impairment testing. Identifying an unconventional play as Marcellus as a CGU could at first glance seem to be similar to the practice of identifying each conventional field as a CGU.

Although the cause for identifying a field as the CGU for conventional resources often is dependencies in the cash inflows generated by other factors such as infrastructure, there is also an underlying geological rationale. Conventional reservoirs are found in reservoir rock and constitute a continuous accumulation of hydrocarbons. This means that all parts of the reservoir communicate with each other. The implications of this, is that although several wells may be drilled, they are all aimed at extracting the same hydrocarbons. Although drilling more wells will increase the ultimate recovery ratio, the production volume to be derived from one well is not independent from the other wells.

The above geological rationale is not present for unconventional resources. While the hydrocarbons in conventional reservoir have migrated from the source rock where it was made and been trapped in a reservoir rock with good qualities for recovery, reservoir rock and the source rock is one and the same for unconventional resources. Unconventional resources are in other words still trapped in the source rock, with very bad qualities for recovery and hence the need for fracking. The implications of this is that, contrary to what is the case for conventional reservoirs, there is little or no interdependencies for the productivity between singular wells drilled into the rock formation. The EIA speaks of the significant variances in productivity even over short distances caused by this shale rock heterogeneity[2]. Due to dependencies caused by other factors, a bottom-up analysis identifying reasonable CGUs for unconventional resources is still expected to be at a higher level than the individual well.

Infrastructure aspects may also be relevant in a direct evaluation of the revenue separation. If the wells in several fields all depend on shared infrastructure to the extent that all fields must be shut down if the shared infrastructure is out of operation, then it could be argued that the fields constitute

[2] EIA 2013 report: Technically recoverable shale oil and gas resources, pages 17 and 18

one CGU. In the predominantly conventional North Sea, this will typically be the case for so-called satellite fields. If the central "host" platform shuts down, the satellite field will be shut in.

Finanstilsynet has not performed a complete bottom-up analysis for the Marcellus shale play or Statoil's other unconventional assets. However, Finanstilsynet generally notes that a cluster of wells, together with a local gathering system (small pipelines bringing gas to a mainline pipe) and any local processing facilities, may serve as a starting point for an analysis. Within such local systems, if the gathering pipeline, the gas processing plant or the compressor connecting the gathering pipelines to the mainline breaks down, all the wells linked to the gathering system will effectively be shut in. Hence, the cash inflows from the wells in such a local system, does not seem to be independent of each other. In the bottom-up analysis potential interdependencies caused by inter-/intrastate pipelines will subsequently have to be assessed (see below).

Asset separation - operations, markets and infrastructure

The primary factor in identifying a CGU is the requirement to identify it at the lowest level that generates cash inflows that are largely independent. A small dependency in cash inflows between assets or groups of assets should not lead to an identification of a CGU at a higher level. References in IAS 36.69 to how management monitors the entity's operations or makes decisions regarding capital allocation, the continuation or disposition of the entity's assets/operations etc. are secondary considerations, and therefore CGU identification may be required at a lower level.

In considering the Marcellus area as one CGU, Statoil seems to put significant weight on how the asset is managed. In evaluating these arguments Finanstilsynet has considered publically available information about the area and information forwarded by the Statoil during the course of the review process.

From Finanstilsynet's understanding, Statoil's management monitors, makes strategies, operates, allocates resources and makes decisions on acquisitions, continuation or disposals at a more regional level than the Marcellus shale play as a whole, cf. IAS 36.69. Examples of this, is that some infrastructure investment decisions related to the development of certain sub areas within the Marcellus are made at Statoil ASA board of directors level.

In its correspondence with Finanstilsynet, Statoil has described two areas within the Marcellus. On page 12 of its letter of 1 July 2013, a southern area in the wet gas window, but with poor market access for the associated dry gas is described:

> "*This gas is currently sold into the local market. But given the future production forecast versus current take-away capacity, this could result in downward pressure on local production area prices (i.e. basis), distressed sellers and even shut-in production*."

Secondly a northern production area, predominantly with dry gas, is described. Although Statoil describes there to be a lack of take-away capacity and distressed sellers also in the northern area, [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……]

A major part of Statoil's "managed as one" argument relate to what it deems to be dependencies in cash inflows caused by resource allocation/capex prioritization within the field. Statoil has exemplified this by Marcellus management decisions the last years to shift focus, CAPEX and physical relocation of contracted drilling rigs to the wet gas rich southern production area.

In Finanstilsynet's opinion, the management level that such capital allocation decisions are made at, can in itself not be the deciding factor in identifying the CGU. As highlighted in public communication, Statoil will normally have more than 100 discoveries world-wide under evaluation for development, and these are evaluated up against each other and prioritized based on identical key financial requirements. A decision to allocate capital to develop a certain field in the North Sea is taken on a management level and will impact competing projects in Norway – and potentially on a global basis. The combined CAPEX requirements to develop the entire Marcellus, is approximately the same size as what is reported to be the capital needed to develop Statoil's gas discoveries offshore Tanzania. This clearly drives a dependency in where cash inflows are generated – even across segments. Finanstilsynet finds that the management level at which capital allocation is decided, is not a precise enough factor, and does not create sufficient dependencies in cash inflows to be the deciding factor in identifying the correct CGU level in a bottom up analysis.

The inability to allocate certain IAS 16/38 assets to independent cash inflows may on the other hand be an indication that a CGU has been identified at too low a level. For example if two or more wells share a common pipeline or processing facility necessary to bring the intermediate product to a place where it can be sold to an independent party (e.g. a natural gas hub), then largely independent cash inflows should be deemed generated at a higher level than the individual well. To Finanstilsynet's understanding there are no such assets included in the CGU which cannot be allocated at a lower level than Marcellus as a whole. Wells in different areas within the Marcellus are capable of producing, transporting and selling output to external end users without being reliant on any such one infrastructure feature.

The Marcellus shale is an asset in the operating segment Development and Production North America ("DPNA"). The actual extraction of hydrocarbons is performed by the DPNA. This production is then sold on to entities within the operating and reporting segment Marketing, Processing and Renewable Energy ("MPR"). [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……]

Finanstilsynet understands there to be a market with willing buyers and sellers for the natural gas (dry gas, predominantly Methane), as well as all or most of the fractions of NGL (Ethane, Propane, Butane, Condensate). From the guidance in IAS 36.71 related to intercompany transactions of outputs for which there is an active market, Finanstilsynet finds that for such commodity based industries, the focus is on the asset's or group of assets' *ability* to generate independent external cash inflows, rather than any possible dependencies caused by the mid-/downstream segment's value adding activities by grouping, transporting and selling.

[……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……] From what Finanstilsynet understands, the Federal Energy Regulatory Commission ("FERC") has promoted the establishment of market centers and hubs to facilitate interchange of natural gas volumes across pipeline systems. Although the Henry Hub in Texas is the most significant such market center, there are others respectively serving the southern and northern production areas of the Marcellus. In addition to the market centers, there are other trading hubs at the intersections of the major pipelines within the Marcellus shale play. In addition to facilitating the buying and selling of natural gas, there exists a financial futures market for several of them. The existence of several trading hubs within the Marcellus play seems to indicate that there is revenue separation. Each of these more local areas could generate separately identifiable cash inflows.

In a March 2007 update, IFRIC, the IFRS-interpretation body, refused an interpretation request based on the arguments of shared infrastructure, marketing and pricing policies and human resources. IFRIC noted that IFRS requires CGU's to be identified on the basis of cash inflows rather than independent net cash flows. Outflows related to shared infrastructure and marketing costs are not to be considered. Finanstilsynet views infrastructure arguments to be relevant to the degree it causes significant dependence in the cash inflows, and do not find sufficient support for this to be the case for Statoil's activities in the Marcellus Shale Play.

In evaluating Statoil's operation, market and infrastructure argument for viewing the Marcellus Play as one CGU, Finanstilsynet has also made a comparison to the CGU definitions of conventional assets in the North Sea. In both areas there are extensive and intricate pipelines offering interconnectivity. In the North Sea, the Gassled pipeline system has been under joint ownership since 2003 with Gassco as a single operator trusted with ensuring open and undiscriminatory access to the transportation capacity. In the Marcellus on the other hand, the major inter-/intrastate pipelines are owned and operated by a number of different mid-stream operators, as well as some multinational oil companies, and the prevalence of long term capacity contracts for these pipelines cause less free volume to be available and constraints to occur. As with the Marcellus production, Statoil's MPR segment is responsible for the transportation and sales. MPR optimizes values from all North Sea production irrespective of which field in the North Sea it comes from, if it is volumes sold on behalf of the SDØE (States Direct Financial Interest) or other third party volumes. The volumes are allocated and sold under short term or long term contracts irrespective of which field it comes from. Although each field in the North Sea is deemed by Statoil to generate independent cash inflows, the operations, market and infrastructure arguments presented by Statoil as reasons for determining the Marcellus play as one CGU, seem more present in the North Sea.

In relation to Statoil's argument that there is an industry practice to define each shale play as a CGU, Finanstilsynet has not come across information among Statoil's peers that contradicts or confirms this. Disclosures are mostly generic and provide limited information to the level at which CGUs are identified. Finanstilsynet assumes, however, that GAAP differences among these peers, such as IFRS vs US GAAP and full cost vs successful efforts accounting, as well as the differing materiality of the individual peer's shale play assets would make any comparison of the actual application of the CGU accounting principle difficult. In drawing its conclusions Finanstilsynet has nonetheless assumed that many of Statoil's peers also have identified individual shale plays as one CGU.

In general, Finanstilsynet is of the view that identification of an entities CGU's requires assessment of various factors, many of which are expected to be entity-specific and involve the entity's particular circumstances and nature of its operations. As a result, what one entity identifies as a CGU may differ from that of another entity, even though the two entities are of comparable size and operate in the same industry. This makes an industry practice argument less compelling for CGU identification. Specifically for Marcellus, Finanstilsynet has made note of the fact that Statoil, together with its partner Chesapeake, are the leaseholders with the largest degree of geographical dispersion. Peer companies generally only have licenses across a few counties, and there may be relative differences in the significance of the assets. This may explain differences in the number of CGUs they identify their Marcellus assets to consist of.

In summary, identification of an entity's CGUs requires careful consideration. It is a bottom up evaluation that first and foremost must reflect the IAS 36 requirement to identify CGUs at the lowest level with largely independent cash inflows. If an entity's assets consist of activities that operate with separate facilities and sales points, those facts support identification of CGUs at a lower level. Finanstilsynet has not found Statoil's identification of all its assets in the Marcellus shale play as one CGU to be consistent with reasonable judgment in compliance with the requirements in IAS 36. Identification of CGUs at a lower level should have been made.

1.4 Statoil's reply to the advance notification of decision

Statoil has during the review process indicated that it would view any re-definition into more than one CGU as a reorganization allowing for a redistribution/-allocation of historic cost to the different CGUs (similar to IFRS rules relating to goodwill). Finanstilsynet expected that this to a large extent would neutralize the effect of identifying more CGUs. The Expert Committee was therefore asked to discuss which principle would apply for relating book values to CGUs if Marcellus for impairment testing purposes was deemed to have consisted of more than one CGU. The Expert Committee decided to include its views on this in its statement, which is attached hereto.

In its letter of 27 January 2014 and subsequent correspondence with Finanstilsynet, Statoil has informed Finanstilsynet that based on the advance notice of decision a preliminary re-evaluation of Marcellus into more than one CGU has been carried out. Recoverable amounts for the newly identified CGUs in excess of the book values have been calculated using 2012 input. Each play will in the future be subject to an annual review where the CGU definition is evaluated. In the letter, Statoil also states that "*the Marcellus asset is in early phase of development. Less than 10 % of the planned number of wells have been drilled and as such the asset is for all practical purposes mainly an IFRS 6 asset*".

Finanstilsynet has not reviewed Statoil's re-evaluation of Marcellus into more than one CGU or the impairment tests performed. Finanstilsynet emphasizes, however, that for assets covered by IAS 16/38, Marcellus shall be split into more than one CGU based on the bottom up analysis prescribed by IAS 36. IFRS 6 rules for recognition and impairment of assets deviates from IFRS rules for other tangible and intangible assets, and only apply for assets that fall within the scope of the standard. IFRS 6.17 states: "*An exploration and evaluation asset shall no longer be classified as such when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable*". Such reclassification is typically performed when the decision to develop a resource is made, long before production start. Almost 2/3 of the book value of Marcellus was classified in Statoil's 2012 annual report as "Property, plant and equipment" and therefore covered by IAS 36.

In letter of 28 February 2014, Statoil states that it will perform a re-evaluation leading to more than one CGU being identified for the Marcellus Shale Play. For other unconventional plays defined as one CGU, Statoil will perform a re-evaluation of the CGU identification per year-end 2013. Statoil will further correct errors made in accordance with IAS 8.

Statement from the Expert Panel - Determining the Cash Generating Unit ("CGU") for the Marcellus Shale Play

The Expert Panel unanimously agreed the following statement:

Determination of CGUs according to IFRS is a bottom-up process. A CGU is the smallest group of assets for which cash inflows are largely independent (IAS 36.68, IAS 36BZC.115). A well or a collection of wells and associated processing assets which produce identifiable hydrocarbon products with a ready market, will according to the IFRS definition constitute a CGU. It follows that common geological features are not relevant for the determination of CGUs unless the geology is such that production in one area (well) influences production from other areas (wells). Similarly, the fact that natural gas from different areas are transported in the same infrastructure is irrelevant unless the volumes that are transported from one area somehow depends on volume transported from other areas. According to IAS 36, the reporting entity may also consider how management monitors the entity’s operations and makes decisions about continuing or disposing of assets and operations (IAS 36.69). However, additional guidance makes clear that arguments based on such factors should not be carried too far (IFRIC Update – March 2007: Identifying cash-generating units in the retail industry). The Expert Panel concludes that the arguments presented by Statoil do not support the company’s decision that the Marcellus Shale play as per yearend 2012 consists of one CGU.

The Expert Panel further discussed which principle would apply for relating book values to each CGU, if the Marcellus Shale play for impairment testing purposes as per yearend 2012 consists of more than one CGU. The Expert Panel agreed that the issue is how to allocate assets to CGUs with their current carrying value, not reallocating carrying value to asset. The allocations made in the past for determining depreciation according to the unit of production method, would be a natural starting point for further evaluation.

Appendix C

1. Cash Generating Unit identification – Cove Point loss contract

1.1 Introduction

The Statoil Natural Gas[1] ("SNG") CGU consisted of the Snøhvit LNG gas contract (including the right to divert these volumes), take-or-pay contracts related to capacity at the Cove Point LNG import terminal in Maryland, USA and related gas trading activities connected to these assets. Statoil redefined its SNG CGU and established a separate provision for the onerous capacity contracts in Q1-2013.

Before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets dedicated to that contract, cf. IAS 37.69. IAS 36.72 further states that a CGU shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.

1.1.1 Background

The Cove Point take-or-pay capacity contracts controlled by Statoil and included in the SNG CGU up until Q1-2013 can be divided in two; LTD-1 volumes related to the original facility and the volumes related to the terminal expansion project ("CPX contracts"). A number of different contracts securing related rights are associated with each of these two capacity contracts. Under take-or-pay contracts the agreed payments must be made irrespective of actual usage.

The Cove Point LNG import terminal is owned by Dominion Resources Inc. Statoil first acquired import capacity at the terminal through a transaction with El Paso in November 2002. Against a cash payment of USD 210 million, SNG entered into an agreement with El Paso to acquire its 30% of the LNG import capacity at Cove Point (the LTD-1 volumes), as well as re-purchasing El Paso's Snøhvit LNG purchase agreement. According to Statoil, USD [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……] million of the acquisition cost in this transaction was allocated to the repurchased Snøhvit LNG contract.

In 2001, El Paso had signed a long term agreement with the consortium "The Snøhvit Seller Group" for approximately 60% of the estimated annual Snøhvit production. Under the Snøhvit LNG contract, El Paso paid a Henry Hub spot price quoted at NYMEX. The sellers were responsible for all cost related to the transportation and the regasification cost incurred at Cove Point. Henry Hub is located in Louisiana and is the most liquid natural gas trading hub in the US. The LNG purchase contract and El Paso's Cove Point import capacity were for similar volumes. The trade terms under the LNG sales contract transferred entitlement to the buyer (El Paso) when the LNG was loaded onto ship at the Melkøya terminal. El Paso consequently had the right to redirect the LNG volumes to delivery points other than Cove Point.

[1] Statoil Natural Gas LLC ("SNG") is a legal entity part of Statoil's US activities in the MPR (Marketing, Processing and Renewables) segment.

In 2006, the SNG CGU was enlarged to include a take-or-pay capacity contract related to an expansion project at Cove Point ("CPX volumes"). The expansion was completed in 2009 and almost doubled Cove Point's total storage and output capacity. While the share of the terminal's LTD-1 capacity was 30%, Statoil signed up for 100% of the expansion volumes. This capacity contract originally ran until 2029. Based on information received by Statoil in its letter of 2 September 2013, Finanstilsynet has understood that this added import capacity was not intended for the Snøhvit volumes:

> "*The CPX-agreements were originally entered into to be used as tools to make Statoil attractive for participation in upstream LNG-projects, to create value from equity and third party LNG to Cove Point and to add value through arbitrage between Europe and USA."*

In the same letter Statoil describes the developments in 2009 and 2010 as follows:

> *"Mainly based on deteriorating forward and long term price assumptions for US natural gas sales and a related increasing spread between US and European gas price assumptions, Statoil changes the company's utilization outlook for its CPX capacity in the first half of 2010. [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……"*

These price changes also made it less attractive to ship the LNG under the repurchased El Paso Snøhvit LNG contract to the US market. SNG at this point entered into an agency agreement whereby Statoil ASA was charged with executing any resale of Snøhvit LNG cargoes other terminals than Cove Point, for the sole risk and reward of SNG.

In September 2010 Statoil informed Dominion that it was evaluating whether to withdraw from the Cove Point contracts through payment of a fixed sum of liquidated damages or a commercial agreement. Later in 2010, Statoil initiated renegotiations with an internal mandate to reduce Statoil's CPX exposure to an expected post-negotiation negative net present value of MUSD 800 or less. In an agreement signed 26 January 2011, Statoil among other achieved a reduction in the duration of the CPX agreement from 2029 to 2020 and large reductions in the capacity in 2017-2020. As a result, Statoil's nominal future CPX payments were reduced by a total of USD [……Text deleted. FIA § 13 (1), cf PAA § 13 (1) no 2……], constituting approximately a 50% reduction in the net present value of the obligation.

In its letter of 27 January 2014 Statoil states that at the time of renegotiating, Statoil continued to have concrete expectations of future use of the remaining Cove Point import capacity:

> "*Statoil's commercial expectations at that time were that the remaining capacity would be utilized in the range between 20% and up to 60% for certain years and therefore would contribute to the CGU's cash inflows and activities.*"

Subsequently, the onset of the US shale revolution contributed to the continued deterioration in US natural gas spot prices and increased negative price spread between the US and other regional markets. As a result of this, Statoil updated its economic planning assumptions ("EPA") during the second quarter of 2011. Statoil's future natural gas price projections then implied a:

> "*considerable and continuous negative spread between the US gas market and the NBP (The National Balancing Point (UK)), also in the long run*".

In its updated expectations of future use of the Cove Point capacity, Statoil in Q2-2011 foresaw:

> "*a usage percentage of nil for the remaining time line of the capacity contracts*"

Statoil has further informed that during 2011, it only a shipped a total of 4 LNG cargoes to Cove Point, while all the other LNG volumes under the El Paso Snøhvit contract were redirected to other markets (from Snøhvit in total, a cargo is sent approximately every 5 days). In 2012, a total of 0 (zero) cargoes were sent by Statoil to Cove Point.

The shale revolutions and the change in future natural gas prices also affected the plans of Dominion Resources Inc. for its Cove Point LNG import terminal. After having applied for and been granted authorization to enter into long term contracts for the export of LNG in 2011, it started a pre-filing process with the FERC[2] in June 2012 for a USD 3,8 billion project redesigning Cove Point into a LNG export terminal. This was publicly known at the time.

In October 2012, Dominion initiated renegotiation of the Cove Point Expansion capacity. Statoil set a mandate for the negotiations in early November 2012, which was not achieved. The renegotiations ceased in mid-December 2012. At year-end 2012, Statoil retained the remaining capacity rights and related obligations stipulated in the 26 January 2011 agreement.

On 6 March 2013, Dominion contacted Statoil with a view to early termination of the CPX agreements from 1 August 2017, followed by immediate renegotiation meetings. An early termination agreement for the CPX volumes was signed on 19 March 2013. Statoil has emphasized that Dominion still has legal obligations to provide Statoil with import capacity. Statoil still retains the LTD-1 capacity until 2023, and also CPX capacity until April 2017.

1.2 Statoil's evaluation

Due to falling US natural gas prices and expectations of low future prices caused by new domestic shale gas production, Statoil started viewing the Cove Point take-or-pay capacity contracts as onerous (loss) contracts from 2010. In Statoil's disclosure of accounting principles, the following is stated:

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[2] Federal Energy Regulatory Commission

"*A contract which forms an integral part of the operations of a cash generating unit whose assets are dedicated to that contract, and for which the economic benefits cannot be reliably separated from those of the cash generating unit, is included in impairment considerations for the applicable cash generating unit.*"

Statoil had from inception included the Cove Point capacity contracts in the SNG CGU. Although the expected usage of the Cove Point capacity was gradually reduced, Statoil still regarded that the economic benefits of these contracts could not be reliably separated from the acquired intangible asset in the form of the repurchased El Paso Snøhvit LNG contract. Statoil hence continued to include the capacity contracts in the SNG CGU and recognized any impairment loss on the El Paso Snøhvit LNG contract before establishing a provision for the onerous capacity contracts.

In Q3-2010 Statoil's Cove Point utilization outlook had changed so much that it recognized both an impairment loss on the El Paso Snøhvit LNG contract, as well as a provision for future losses under the Cove Point capacity contracts, in total NOK 3,6 billion. As a result of the renegotiation of the Cove Point agreements in the subsequent quarter, Statoil made a NOK 2,7 billion reversal of the provision (and impairment) in Q4-2010.

As the negative natural gas price spread between the US and other regional markets increased in the subsequent reporting periods, so did the value of the El Paso Snøhvit LNG component of the CGU. This was caused by expectations that more of the LNG volumes would be redirected to markets outside the US. A further increase in the value of this component in Q1-2010, lead Statoil to reverse the remaining Cove Point onerous contract provision and the prior impairment of the acquisition cost of the repurchased El Paso Snøhvit LNG contract in the SNG CGU. From this point on, the recoverable amount of the total SNG CGU exceeded the book value of the El Paso Snøhvit LNG contract.

Up until Q1-2011 Statoil's economic long term planning assumptions ("EPA") included an assumption that the negative price spread between the US and the rest of the world would eventually disappear. However, from Q2-2011 the EPA was changed to reflect that the observed negative price spread was not expected to converge. This was what in Q2-2011 caused Statoil to revise its utilization outlook for the Cove Point capacity contracts to "*a usage percentage of nil for the remaining time line of the capacity contracts*". Statoil has, however, noted that it retained the right to use the terminal, which was an option with economic value because of possible future short term fluctuations or shifts in gas prices.

Statoil's accounting policy evaluating guidance in IAS 37.69 and IAS 36.72 relating to the inclusion of loss contracts in CGUs was outlined in an internal accounting memorandum of March 2009. On this background, and given the facts and circumstances relating to the expected non-usage of the Cove Point capacity contracts, Statoil's initial analysis in Q2-2011 indicated that the contracts were no longer dedicated to the rest of the CGU, that a change of the CGU was justified and a separate provision should be established. In this preliminary evaluation, Statoil reflected on the assumption that IAS 36.72 and its "justification requirement" was mainly written with the view of not giving issuers an opportunity to avoid impairments by rearranging CGUs. Subsequently to this preliminary evaluation, Statoil initiated a more in-depth evaluation of the specific issue relating to the Cove Point capacity contracts and the SNG CGU. Accounting memorandums, prepared by both Statoil as well as its external auditor, were presented to Statoil's Audit Committee.

In general, Statoil found there to be no guidance in IFRS and also very little available guidance from other reputable sources in applying the mentioned paragraphs. However, the in-depth evaluation caused Statoil to conclude that "*the threshold is not lower for a split of one CGU into several or for extracting parts of a CGU that it is for a combination of CGU's. There is one requirement for all changes: That such a change must be justified.*" Statoil has informed that it applied its best judgment and weighed all facts and circumstances and guidance in reaching its conclusion for the Cove Point contracts.

The internal memorandum that formed the main basis for Statoil's final conclusions further focused on whether the requirements to justify a change in the CGU were stricter than what would constitute triggers for an impairment evaluation. The memorandum concluded that this was the case, and as such that considerable caution would be needed in applying changes in internally developed assumptions as the main or sole basis and justification for changing the composition of the CGU. The memorandum concludes that:

> *"It is our view that to be able to justify a change of the definition of a CGU, a significant event must have occurred which changes the operation of the individual assets or components within the CGU. Examples of such events may be:*
>
> - *A management decision that results in a significant change in the organization of the CGU, strategy for its use or future operations of the individual assets or components (including contracts) of the CGU.*
> - *Significant change in the actual operations of the assets or components (including contracts) within the CGU*
> - *Actions which affects the future operation of the assets or components (including contracts) within the CGU*
> - *If the entity reorganizes its reporting structure in accordance with IAS 36.87 or dispose part of its business in accordance with IAS 36.86*
>
> *It is our view that a change in the internal economic assumptions is not in itself normally sufficient to justify a change in the definition of a CGU."*

As a result of the in-depth analysis, Statoil at the time established the following criteria for re-defining the CGU and booking an onerous contract provision:"- *Positive management decision not to use the terminal capacity, where the decision should involve permanent and/or irreversible non-usage consequences, or, alternatively;-expectations of no utilization to be sustained and evidences over an extended time period (i.e. trend establishment)*".

Statoil did not find these criteria to be met as per Q2-2011. There had been no significant changes to the operations of the CGU. At that point Statoil still retained the legal rights to the import capacity, and although the current expectation was that the capacity would not be used, this situation had not existed over a sufficient time period.

In replying to Finanstilsynet's line of argument in the advance notice of decision, Statoil has elaborated on its views and Q2-2011 analysis of the threshold for changing the CGU in the following way:

> "*The Cove Point terminal capacity was an integral part of the SNG CGU, and was central to the CGU's business case and related cash inflows from the start-up of Statoil's US LNG import activity… the Cove Point capacity originally did contribute to the SNG CGU's cash inflows, and was at the earlier stages of the CGU's commercial life obviously expected to continue to contribute. Once the "no-use" expectation was reached at a later stage, the requirements to justify a change in the CGU would be stricter than at initial definition of the CGU, as long as the components in the CGU were the same and there was nothing in the actual CGU operations beyond internally established assumptions to pinpoint one component as non-contributing.*"

Furthermore, Statoil highlights that it does not disagree that there was a negative trend in prices leading up to Q2-2011, and that the changed internal economic planning assumptions (EPA) reflected this. However, in relation to the above mentioned criteria Statoil holds that the trend requirement is related to the "no use" expectation and that "*establishing a trend of sustaining that expectation would necessarily require passage of time after that point*" (Q2-2011)…". As long as management did not act on the market developments and trends to actively change the CGU, the issue at hand in applying IAS 36.72 did not rest directly on the various market trends described by Finanstilsynet.

Statoil monitored the criteria in subsequent quarters, and at year end 2012. No change was considered justified until the first quarter of 2013. In its 27 January 2014 answer to Finanstilsynet's advance notice, Statoil gave the following account of its evaluations in the period Q3-2011 to Q4-2012:

> *"From 3Q 2011 and onwards Statoil continued to monitor the situation and activities of the SNG CGU. Until 1Q 2013 the situation did not change materially. The CGU was profitable, the Cove Point capacity contracts showed minimal usage and the expectation of future usage did not improve. Towards year end 2012, when the situation had lasted beyond a year and a trend in sustaining internal expectations of "no use" might conceivably have been considered, Statoil management terminated capacity reduction negotiations initiated by Dominion. Statoil management therefore was active; – not in changing the CGU, but in preserving its commercial status quo. On this basis the composition of the CGU was considered reconfirmed rather than changed. Consequently at year end 2012 the IFRS evaluation remained unchanged, and the terminal capacity remained within the CGU."*

1.3 Finanstilsynet's evaluation

Finanstilsynet is of the opinion that Statoil in financial reporting preceding Q1-2013 applied criteria that constituted a higher threshold for redefining the SNG CGU than what a reasonable application of IAS 36.72 allows for. Furthermore, Finanstilsynet finds that a separate onerous contract provision should have been established for the Cove Point capacity contracts prior to Q1-2013.

Statoil's evaluation of the SNG CGU in Q2-2011 concluded that a CGU redefinition could only be performed if there is either a positive management decision, or a no-use expectation over an extended period of time. Finanstilsynet finds aspects of Statoil's argument in line with a general thought that a change with certain "substance" must have occurred. As such, the example "*Significant change in the actual operations of the assets or components within the CGU*", seems to have relevance, as it could also change the expected cash inflows. However, further elaboration on these criteria primarily builds on the presumption that a change needs to be caused by active management decisions. The criteria thus seemingly rule out that a change can be caused by reliable and supportable events outside the control of the entity. Statoil operationalized these "event-criteria" into a requirement of an active, permanent and irreversible management decision not to use the terminal capacity. The prominent way such a need for "positive management decisions" features in the evaluation, contributes to generate a higher threshold than what can be supported by IFRS. Although Finanstilsynet assumes that such an irreversible decision not to use the Cove Point terminals would make a redefinition of the CGU justified, even the 19 March 2013 termination agreement would not qualify as such an event.

Finanstilsynet's evaluation below therefore focuses on the criteria "*no-use expectation over an extended period of time.*" The evaluation of whether the Cove Point capacity would be used effectively includes an evaluation of whether the contracts were expected to generate future cash inflows (not just costs). Finanstilsynet views Statoil's no-use assumption of the capacity contracts to be central to the evaluation of the "dedicated" and "justifiable" criteria IAS 36.72 and IAS 37.69.

Finanstilsynet agrees with Statoil that neither the accounting standard's Basis for conclusion, Illustrative Examples or other available material from the IAS elaborate on the term "justifiable" in IAS 36.72. It is Finanstilsynet's view that the evaluation of when a change in the composition of a CGU is justified (cf. IAS 36.72), must then be made with the standard's other guidance relating to CGU identification in mind. First and foremost, the definition of a CGU as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets is relevant (cf. IAS 36.6).

The evaluation forming the basis for Statoil's Q2-2011 conclusion included an analysis up against some such other aspects of IAS 36. Primarily this consisted of a comparison of criteria that trigger an impairment evaluation and criteria that make a CGU redefinition justifiable. Statoil concluded that the justification for changing a CGU must be something more than an impairment trigger. Finanstilsynet shares this view, but does not see how it is directly relevant in reaching a conclusion for the question at hand.

Statoil's evaluation further underlines that the changed utilization outlook was based on changes in the EPA future natural gas prices, and that such internally established assumptions should not be given too much weight. Finanstilsynet finds that this evaluation of the Cove Point capacity contracts underplays the fact that the negative spread was not caused by temporary volatility or short term demand/supply unbalances. Rather, the changes to the EPA expectations were preceded by a fundamental and well-known factor profoundly changing the international flows of natural gas; the US shale gas revolution. Statoil's changed assumptions were not opposed to, but rather consistent with these changes to external forward prices and actions by others in the industry known at the time. As such, the changed assumptions in Q2-2011 cannot be viewed as being first and foremost "internal".

Finanstilsynet is of the understanding that Statoil's original business case was to make use of the then positive price spread between the USA and the rest of the world, and that this was expected to prevail for some time. However, during 2005/2006 this positive price spread turned first slightly negative – then accelerating from 2009. Finanstilsynet is aware that both economic supply/demand incentives, as well as a certain amount of statistical mean-reversion, make a degree of price convergence a feature of most long term price models. Statoil underscores that up until Q1-2011 its EPA assumptions (long term prices etc.) included an assumption that the negative price spread between the US and the rest of the world would eventually disappear. From Q2-2011 Statoil changed its EPA to reflect that the observed negative price spread was not expected to converge.

Statoil agrees that a sustained price trend caused by the shale gas revolution (potentially making USA self-sufficient) preceded their Q2-2011 EPA update. However, Statoil emphasizes that in relation to its operationalization of the "justifiable"-criterion, it was the "no use" conclusion and not the price trend that had to be sustained.

While Finanstilsynet finds that the trend in natural gas prices caused by the shale gas revolution is not a stand-alone argument for changing the CGU, it is, however, closely linked to how much the actual operations and expected use of the assets or components within the CGU has changed since Statoil's original business case. Specifically, the change in the price expectations is closely related to Statoil's assumptions of how much of the Cove Point capacity will be used.

In its 9 January 2014 letter, Statoil states that at the time of the first major re-negotiating in Q4-2010, its expected use in future periods varied from 20% and as high as 60% some years. While international spot natural gas prices increased over the next 6 months, Henry Hub spot prices continued to hover around 4 USD/mmbtu, prolonging the negative price differential trend. Although the Q4-2010 renegotiations among other things had reduced the duration of the Cove Point contracts from 2029 to 2020, Statoil had in Q2-2011 reduced it expected use to virtually nil for the entire life of the Cove Point contract.

Theoretically, a CGU could be defined with several overlapping / mutually exclusive components. Under such a scenario, a "no expected usage" conclusion related to one of the components would then not be inconsistent with the original business case. However, Finanstilsynet does not find this to be the case with the SNG CGU.

Statoil argues that although subsequent changes to economic assumptions will change expected utilization, cash flows and the value of the individual components of the CGU, this is not a justifiable reason to split the CGU. Specifically, in the case of the SNG CGU, Statoil highlights that the change in economic assumptions just resulted in the value of the El Paso Snøhvit LNG contract component increasing, at the expense of an increase in the negative value of the Cove Point capacity contracts. The value of the SNG CGU as a whole was, however, according to Statoil consistently positive subsequent to Q1-2011. Furthermore, Statoil writes that in their opinion:

> "*the requirements to justify a change in the CGU would be stricter than at initial definition of the CGU, as long as the components in the CGU were the same and there was nothing in the actual CGU operations beyond internally established assumptions to pinpoint one component as non-contributing.*"

Finanstilsynet finds this may be true to a large degree. However, changes in circumstances that reduce the expected usage, and thus expected cash inflows, from one of the components of the CGU to virtually nil are deemed to change key interrelations between the components. These interrelations are the characteristics that originally lead to the conclusion that the components were dedicated to each other (IAS 37.69) and that the cash inflows were not largely independent of each other (IAS 36.6).

With an expected usage for the remainder of the contract duration of virtually nil, Finanstilsynet finds that Statoil did not expect that the Cove Point capacity contracts would generate any cash inflows (only costs). The legal option to use capacity should be evaluated in the light that Statoil deemed the probability for future utilization as remote. Furthermore, Dominion must still provide certain import capacity, also after 2017. The continued existence of an option indicates that any such element in the evaluation should not have been significantly changed by the signing of the early termination agreement in Q1-2013

As Statoil no longer expected to make own use of (or sell to others) the capacity at the Cove Point terminal, Finanstilsynet finds it difficult from that point onwards to view the capacity contracts as either being an integral part of the process flow or contributing to cash inflows generated by other assets in the SNG CGU. The expected usage of the capacity contract, and hence the expected inflows of cash, were nil in Q2-2011. It can be argued that from that point on, the other assets in the CGU generated cash inflows independently of the onerous contract.

As mentioned above, the prominence of active management decisions in Statoil's criteria to a large degree seems to rule out that reliable and supportable events outside the control of the entity can cause changes to the actual operations of the components of the CGU. That being said, the accounting memorandum that formed the main basis of Statoil's final conclusions also opened up for a "qualifying event" that was not related or backed up by a management decision:

> "*A significant change in the expected future economic environment in which an asset or contract operates will normally lead to management actively making changes in the operation of the asset or contract, such as those referred to in the examples above. However, if such a change in economic assumptions is stable over a longer period, for instance a year, combined with no or negligible usage in the same period – in sum indicating no use or an idle asset in the foreseeable future – this might in itself be sufficient to justify a change in the definition of the CGU.*"

As mentioned, Statoil delivered only 4 LNG shipments to Cove Point in 2011 and 0 in 2012. Furthermore, prices continued to deteriorate after Q2-2011 and to Finanstilsynet's understanding, Statoil's "no expected usage" evaluation did not change in any of the 6 quarterly reports after Q2-2011 were the SNG CGU was left unchanged. In Finanstilsynet's view these developments subsequent to Q2-2011 serves to further substantiate the arguments for splitting the Cove Point capacity contracts from the SNG CGU.

As mentioned, Statoil views the termination of the capacity reduction negotiations in Q4-2012 as an active management decision "*not in changing the CGU, but preserving its commercial status quo*". Statoil has described that the negotiations were terminated on grounds that the mandate set for renegotiations were not achieved. Finanstilsynet understands this to mean that the terms offered by Dominion were not found satisfactory. Finanstilsynet cannot see how this can constitute an active management decision that reconfirmed the CGU.

Finanstilsynet is of the opinion that Statoil, in preparing its periodic historic financial statements preceding Q1-2013, applied criteria that constituted a higher threshold for redefining the CGU than what a reasonable application of IAS 36.72 allows for. As a consequence, Finanstilsynet has concluded that a separate onerous contract provision for the Cove Point capacity contracts should have been established before Q1-2013. Statoil has in letter of 9 March 2014 stated that it will not define the issue as an error. Finanstilsynet's decision in the matter is included in paragraph 4 of this letter.

Statement from the Expert Panel - Timing of redefinition of the Statoil Natural Gas CGU

The Expert Panel unanimously agreed the following statement:

The issue is when a capacity contract for unloading and processing LNG should be removed from the CGU to which it was originally assigned (Statoil Natural Gas LLC) as adverse market conditions made it evident that the contract would not be used as intended. According to IFRS CGUs should be identified consistently from period to period unless a change is justified (IAS 36.72). There is no general guidance with respect to which events would justify changing a CGU. In the present case, adverse market conditions had been created by a dramatic fall in prices brought about by an oversupply of natural gas caused by new production technologies. Since 2011 Statoil planning assumptions had indicated that the capacity contracts were not expected to be used as the company was not likely to import natural gas to the US in the foreseeable future, because the relevant expected prices outside the US were higher. The contracts were renegotiated in 2010-11. In Q1 2013, a final agreement with the operator was reached terminating part of the contracts in 2017. At that point, Statoil removed the contracts from the CGU, and a provision was established.

There seems to be agreement that the events of Q1 2013 did not indicate new conditions that would justify removing the contracts from the CGU. Statoil's best estimate for several quarters had been that the capacity would not be used. However, the company maintains that changing the CGU would not be justified until "expectation of no utilization ..(had been).. sustained and evidenced over an extended time period (i.e. trend establishment)". It is the company's view that a change in the internal economic assumptions is not in itself normally sufficient to justify a change in the definition of a CGU.

The Expert Panel's concluding remarks
The reporting entity's best estimate since Q2 2011 had been that the capacity would not be used. This implied that the capacity was not expected to contribute to generation of any future cash inflows (although it might still have an option value). It turned out the terminal was only used for four cargoes in 2011 and not at all used in 2012, and Statoil's expected future use of the terminal was unchanged (not expected to be used).The Expert Panel concludes the capacity contract should therefore have been removed from the CGU and a provision established before Q1 2013.

Appendix D

1. Reportable segments and other topics addressed in the review

1.1 Introduction

Finanstilsynet's review has covered a number of topics in addition to the issues descried in appendices A-C. The main areas addressed by Finanstilsynet are described below.

1.2 Reportable segments

Statoil reports its business through reporting segments which correspond to its operating segments, with one exception. In the segment disclosures, the operating segment Development and Production North America ("DPNA") is aggregated with the operating segment Development and Production International ("DPI").

Operating segments are components of an entity for which discrete financial information is available and whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segments and assess its performance. This means that such discrete financial information exists for DPNA and is reviewed by Statoil's top management. Provided that certain requirements in IFRS 8 "*Operating Segments"* are met, entities may opt to aggregate two or more operating segments into one. Statoil's presentation of DPNA and DPI as one reporting segment is hence the result of a choice. Among the aggregation requirements that need to be met is that it is consistent with the following core principle in IFRS 8.1:

> *"An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates".*

Furthermore, the segments need to have similar economic characteristics and be similar in a number of respects listed in IFRS 8.12.

A significant part of Statoil's international growth over the last decade has been focused on North America; first in the Gulf of Mexico, then onshore unconventional shale plays and oil sands. As a result, the non-current assets of DPNA constitute more than half of the aggregated DPI reporting segment. Revenue wise the share is much lower, but this is expected to pick up. Finanstilsynet has asked Statoil why it has chosen to aggregate DPNA with DPI and whether the requirements in this regard are met.

Statoil has in its correspondence with Finanstilsynet underlined that their peer group reporting under IFRS, generally report one upstream segment, and that while all of Statoil's three upstream development and production operating segments show many of the same economic characteristics they are in fact reporting DPI separate from Development and Production Norway. Although there are significant differences from project to project, Statoil does not believe there to be distinguishing factors between DPI and DPNA. Both of the two operating segments have a mix of offshore and onshore activities and unconventional projects are part of both. Relating to the core principle in IFRS 8, Statoil argues that investors generally seek information on a project level and not the segment level to understand the nature and financial effects of its business.

Finanstilsynet observes that Statoil as part of its financial reporting also provide some information on a country, product and project level. However, Finanstilsynet believes that investors would find it relevant to be provided with more distinct financial information per operating segment. Finanstilsynet therefore recommends Statoil to present DPNA as a separate reporting segment in its future financial reporting. The recommendation was included in Finanstilsynet's advance notice for decision, but Statoil has not provided any comments.

1.3 Other

The review has included topics which Finanstilsynet has taken under consideration over the course of the process. These include core aspects of the issuer's accounting principles for recognition and measurement of exploration and evaluation assets, asset removal obligations, certain selected exploration and evaluation assets and fields under development, as well as two P&L presentation issues.

Finanstilsynet has as part of the review looked at whether there were impairment indicators for Snøhvit/Melkøya in 2012. The onset of the shale gas revolution and declining US gas prices put a stop to Statoil's strategy to export LNG to USA. This strategy was a key element to the planning and building of the Melkøya LNG plant. Although the LNG from Snøhvit/Melkøya has found other markets, Finanstilsynet still deemed impairment indicators to be present in 2012. This is partly due to price developments, but mainly due to long running and partly unresolved technical difficulties causing production regularity to fall to 73%. [3]

Statoil does not agree with Finanstilsynet that there were impairment indicators for Snøhvit/Melkøya on 2012. Despite this, the company has performed a calculation of the Snøhvit/Melkøya CGU using 2012-input. The impairment test resulted in a value in use in excess of the book value. During the review process it became apparent that significant deferred tax liabilities were related to Snøhvit/ Melkøya, reducing the net book values of this CGU in Statoil's financial statements considerably. Based on an evaluation of materiality and the received impairment test, Finanstilsynet has decided to take this matter under advisement.

Finanstilsynet has during the process inquired about IAS 39 "*Financial Instruments"* issues related to selected commodity contracts. Based on Finanstilsynet's assumptions related to the materiality of the issues, further work on these matters has been discontinued.

[3] GDF Suez E & P, annual report 2012.