Oil and Gas Investor

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The Bakken is far from played out as producers expand its boundaries.

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BEYOND THE AUDIT

As oil and gas companies continue to grow, accounting firms have gone from being service providers to partners.

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Below left: "We're going pretty far upstream of the finance function where people have tended to identify a firm like ours in the past," says John England, vice chairman of Deloitte LLP and leader of Deloitte's oil and gas practice. Below right: As accounting firms have broadened their service offerings, smaller E&Ps have recognized the need to take advantage of what larger firms provide, says Clark Sackschewsky, tax partner in BDO's natural resources practice.

As accounting firms have further specialized their practices and bolstered their oil and gas sectors with professionals boasting deep backgrounds in the space, an interesting thing has happened: They've gone from being service providers to partners.

"We've always had good relationships with our clients, but I believe our relationships and partnerships with energy companies have strengthened in recent years," says Kevin Schroeder, Grant Thornton's national managing partner, energy industry. "When our clients see we're really up to speed on the industry, they're coming to us for ideas, also. I get a lot more calls from people looking for advice or asking for help regarding potential transactions or capital-raising activities. As an accounting firm, that didn't happen in the past quite as much."

In recent years, many firms have worked to increase their visibility in the industry and reshape their roles by becoming better educated about industry issues and more proactive about clients' needs. As a result, clients are now looking to accounting firms for more than just audits or taxes.

"We're providing a broader array of services to many of our clients today, and because of that they're now looking at us as a trusted advisor," says John England, vice chairman of Deloitte LLP and leader of Deloitte's oil and gas practice. "We're much more operational that we've ever been in the past. We're going pretty far upstream of the finance function where people have tended to identify a firm like ours in the past."

Smaller E&Ps see value

One effect of the increased visibility and broader service offerings by large accounting firms has been an upgrading of service providers by smaller companies, says Clark Sackschewsky, tax partner in BDO's natural resources practice.

"There's been a move for smaller companies to take their work from the local CPA they've been using and move it toward firms with considerable experience in the oil and gas arena," he says. "More companies are coming to the realization that they need a firm with dedicated resources in the oil and gas industry. They pay more for a bigger firm up front, but they receive a bigger payoff because we understand the industry and are dedicated to providing a strong return on our services. We keep them informed on trends, we see things early, and we communicate that to them. That's highly valuable."

In order to provide clients with value-added services in addition to what they expect from accounting firms, many within large firms have placed a high value on continued education about the energy industry to ensure everyone within the practice is fully versed on the most pertinent issues.

"We take pride in our knowledge of the industry, and we need to be educated and know what we're talking about with our clients," Schroeder says. "Our people receive more technical training and attend more energy industry conferences than in the past to ensure they're staying up with the industry and what's going on."

The larger role accounting firms have begun to play with their clients has also broadened their relationships within E&Ps, England says.

"We continue to have very strong relationships at the CFO, CIO and director of tax lev-

Major avenues for funding growth have increasingly included international investors in addition to private-equity firms.

els; those have always been our strongholds," he says. "Now, we're getting better relationships with the COO and commercial leadership. Those relationships have expanded our footprint within our client companies and made us better advisors to them as we have gotten closer to the business itself."

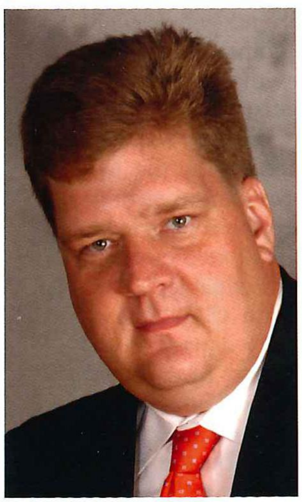
Squeezing value from operations

As the margins on natural gas production continued to shrink in 2013, many clients began to look to their accounting firms for clarity and visibility in their processes to ensure they are squeezing every bit of value from their operations.

"The value chain for gas is very tight, and our clients want to make sure they're getting their value. The best way to do that is to make sure everything is being accounted for correctly," says Wayne Wilson, managing director, UHY Advisors. "We're going back to the days before computers did everything. They want us to run through the allocation process for them by hand so they can better understand how everything is being accounted for. Ironically, they're looking to us to do some of the things nobody does anymore."

Giving clients this increased visibility has added value to the services accounting firms provide. Many clients can run the same computerized systems their accounting firm runs, but the accounting firm can help them get inside the numbers to understand what's really happening, says.

"The electronic revolution has been very successful in providing more efficient operations, but it has had the impact of removing visibility," he says. "We're now asked to provide that visibility that no longer exists. While it costs money to do those analyses, the value chain is so tight; you want to make sure you're maximizing value."



With the value chain for natural gas tight, clients want UHY "to run through the allocation process for them by hand so they can better understand how everything is being accounted for," says Wayne Wilson, managing director, UHY Advisors.

As part of this process, clients are involving accounting firms earlier and for a longer time period than in the past, deepening the business relationship and helping accounting firms provide better counsel.

"Clients want to get you involved earlier now; they realize there are experts in oil and gas that sit in consulting. We work in oil and gas and are consultants; we're not consultants who work in oil and gas. There's a big difference," says. "I have clients calling me for input on a problem before it's a problem. Clients recognize the value of deep, focused expertise in the industry and they leverage that to optimize their company resources."

A benefit of becoming involved with companies earlier is the ability to strategically counsel them through decisions and allow them to envision and think through problems before they occur.

"We work through a lot of 'what if' issues with our clients," says Jon McCarter, Americas Oil and Gas Transaction Advisory Leader for EY. "What people are trying to do is much more complex, and they're watching what others are doing in the marketplace and wondering if it's right for them.

"We look at our firm, decide who the absolute experts are in what our client needs, and make sure we have the right people to answer the right questions at the right time."

Easing growing pains

As the resurgence of domestic oil and gas marches on, many companies are growing at an unprecedented pace. While that is hardly a negative situation, many companies lack the internal accounting structure to support such growth. In the past year, there has been a big opportunity for accounting firms to fill in those gaps.

"We work with a lot of large portfolio companies from private-equity-backed groups, and we've seen a continuous trend of these companies considering the public markets," says Dale Jensen, partner-in-charge, public company audit practice partner, assurance services, at Weaver. "The result of that has been an increased need from our advisory practice for companies to be ready to become a public company."

Jensen says as small companies continue to grow and decide to go public, they often find they're understaffed and underprepared for life as a public company, with stringent quarterly reporting requirements.

"As we see companies mature operationally with a proven track record of developing assets, they often lack the internal control structure maturity truly needed to report from a public company perspective, typically due to a lack of resources," he says. "We're seeing a lot of opportunities to assist companies as they develop those policies and procedures, helping them understand what's necessary to be a public company, and typically assisting in the formalization of these policies and procedures."

Weaver's risk advisory consulting practice is particularly helpful to clients in this situation, Jensen says.

"We help them build the infrastructure to be ready for continued growth," he says. "With the industry the way it has been, companies can grow substantially quickly."

Major avenues for funding growth have increasingly included international investors in addition to private-equity firms. International investors continue to enter the marketplace, primarily with an eye toward the ever-expanding shale plays, and many without any experience investing in the energy industry.

"We've seen significant investments from international investors who need help thinking through the reporting requirements in the U.S. and the accounting ramifications that surround those requirements," says David Zaozirny, partner-financial accounting advisory services for

EY. "As soon as they've gotten through the tax issues, their next question is, 'How do we account for this?'"

The amount of foreign investment coming into the oil and gas industry has lead some accounting firms, such as Deloitte, to launch initiatives focused on walking foreign companies through their U.S. oil and gas investments, England says.

"We're seeing a lot of opportunity to help those companies as they set up companies to explore on the E&P side, but they're also investing in midstream, downstream and the service and supply sector," he says. "We're helping foreign clients across the energy spectrum as they enter the marketplace."

Another source of pain as energy companies grow is often human capital. The endless search for talent is certainly not a new concern in the industry, but many accounting firms are finding new ways to help clients solve the problem of finding, and keeping, the right people in the right jobs.

"We saw concerns around having enough talent to handle all of the growth in the industry manifest into more projects for us in 2013," says. "It's a topic we've heard about for a number of years, and we've really tried to develop capabilities that are helpful to our clients. Our approach has been to put heavy-duty analysis behind the problem to project what the issue will look like within companies, and from there to translate that into an action plan."

To that end, England says Deloitte now has partners focused exclusively on human capital, and the firm has seen significant expansion of that practice over the past 18 months.

Less M&A, more nontraditional deals

With 2013 having a much lower deal count than 2012, many firms have seen a slowdown in direct mergers and acquisitions, their transaction services have kept busy with nontraditional M&A, such as spin-offs, MLPs and joint-venture activity.

"We've been as busy as we've ever been, even though the announced deal count hasn't been impressive [in 2013]," McCarter says. "A lot of people are taking longer to take action and more diligence is happening versus what we saw in 2007 and 2008."

After the flurry of M&A surrounding the start of the shale boom, the industry is focusing less on high-profile M&A and more on strategic M&A, says.

"There's still a fair amount of activity; it's just on a smaller scale," he says. "We're now seeing truly strategic mergers, where resources complement a company's existing resources and fit into the core plan very well."

Many companies are now finding themselves with a good set of assets that need to be exploited, leading them to seek help with operational efficiencies instead of transactions, England says.

"There's been a lot of organic growth in our clients in 2013," he says. "We've seen a focus on operational improvements, and that has meant work for us in process reengineering and systems-related projects; those have been our biggest growth areas. We're also seeing a lot of investment in large capital projects, so we're getting calls to help with advising companies on setting up financial reporting, developing supply chains and even doing tax structuring around large projects."

What's next?

In 2014, accounting firms expect to see continued focus on operational efficiencies as E&Ps further develop their existing acreage.

"People are going to continue to look at their costs to see how they can make their operations more cost-effective," England says. "We expect 2014 to be a year where companies focus on how to efficiently harvest the investment they've been making, particularly in the shale regions. We're going to be helping clients look at what their cost structures should be, how to reduce costs and how to be more efficient in their operations.

Recent changes in regulation are also expected to affect business in the coming year.

"We provide a number of specialty advisory and tax services and we're seeing increased activity in those areas," Schroeder says. "For younger companies that are considering capital-raising transactions, they often lack experience with regulatory and corporate governance expectations. Some may also need assistance with tax planning and compliance, specifically regarding state and local taxes. We are seeing more demand for such advisory and tax services, in addition to our audit services for public energy companies and companies involved with private equity groups."

With the volatility in natural gas prices, accounting firms expect to see their clients either very well-positioned into 2014, or in preservation mode, depending on their production mix.

"We think 2014 will be a much more active year for oil and gas M&A, but the year will likely still be defined by the haves and have-nots," McCarter says. "We have clients worried about very different things. They're either extremely well-positioned or they're overweighted in natural gas and/or have debt due on the horizon. We haven't seen a ton of bankruptcies, but people are either preserving and optimizing or heavily investing."

Regardless of how prices and regulatory issues settle, accounting firms are bracing themselves for another busy year.

"People have production behind their drilling and there's going to be a lot of tax planning going on because of that," Sackschewsky says. "Private equity will continue to be heavily involved in the market; they've seen the light and realized there's money to be made. It's going to be another banner year for the oil and gas industry." □

As more private-equity portfolio companies consider going public, accounting firms are helping them develop the necessary internal control structures, according to Dale Jensen, public company audit practice partner, assurance services, at Weaver.