

CHESAPEAKE ENERGY CORP

Form 10-Q

May 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended March 31, 2016

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File No. 1-13726

Chesapeake Energy Corporation
(Exact name of registrant as specified in its charter)

Oklahoma 73-1395733
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)
6100 North Western Avenue
Oklahoma City, Oklahoma 73118
(Address of principal executive offices) (Zip Code)
(405) 848-8000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES NO

As of April 27, 2016, there were 684,606,831 shares of our \$0.01 par value common stock outstanding.



CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)
 CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

	March 31, 2016	December 31, 2015
	(\$ in millions)	
CURRENT ASSETS:		
Cash and cash equivalents (\$1 and \$1 attributable to our VIE)	\$16	\$825
Accounts receivable, net	937	1,129
Short-term derivative assets	350	366
Other current assets	189	160
Total Current Assets	1,492	2,480
PROPERTY AND EQUIPMENT:		
Oil and natural gas properties, at cost based on full cost accounting:		
Proved oil and natural gas properties (\$488 and \$488 attributable to our VIE)	64,305	63,843
Unproved properties	6,612	6,798
Other property and equipment	2,749	2,927
Total Property and Equipment, at Cost	73,666	73,568
Less: accumulated depreciation, depletion and amortization ((\$445) and (\$428) attributable to our VIE)	(60,506)	(59,365)
Property and equipment held for sale, net	131	95
Total Property and Equipment, Net	13,291	14,298
LONG-TERM ASSETS:		
Long-term derivative assets	263	246
Other long-term assets	311	290
TOTAL ASSETS	\$15,357	\$17,314

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS – (Continued)
 (Unaudited)

	March 31, 2016	December 31, 2015
	(\$ in millions)	
CURRENT LIABILITIES:		
Accounts payable	\$723	\$944
Current maturities of long-term debt, net	343	381
Accrued interest	137	101
Short-term derivative liabilities	86	40
Other current liabilities (\$2 and \$8 attributable to our VIE)	1,544	2,219
Total Current Liabilities	2,833	3,685
LONG-TERM LIABILITIES:		
Long-term debt, net	10,062	10,311
Long-term derivative liabilities	12	60
Asset retirement obligations, net of current portion	453	452
Other long-term liabilities	426	409
Total Long-Term Liabilities	10,953	11,232
CONTINGENCIES AND COMMITMENTS (Note 4)		
EQUITY:		
Chesapeake Stockholders' Equity:		
Preferred stock, \$0.01 par value, 20,000,000 shares authorized: 7,225,713 and 7,251,515 shares outstanding	3,036	3,062
Common stock, \$0.01 par value, 1,000,000,000 shares authorized: 684,560,678 and 664,795,509 shares issued	7	7
Additional paid-in capital	12,521	12,403
Accumulated deficit	(14,123)	(13,202)
Accumulated other comprehensive loss	(99)	(99)
Less: treasury stock, at cost; 1,384,506 and 1,437,724 common shares	(31)	(33)
Total Chesapeake Stockholders' Equity	1,311	2,138
Noncontrolling interests	260	259
Total Equity	1,571	2,397
TOTAL LIABILITIES AND EQUITY	\$15,357	\$17,314

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2016 2015 (\$ in millions except per share data)	
REVENUES:		
Oil, natural gas and NGL	\$993	\$1,543
Marketing, gathering and compression	960	1,675
Total Revenues	1,953	3,218
OPERATING EXPENSES:		
Oil, natural gas and NGL production	206	299
Oil, natural gas and NGL gathering, processing and transportation	482	458
Production taxes	18	28
Marketing, gathering and compression	942	1,700
General and administrative	48	56
Restructuring and other termination costs	—	(10)
Provision for legal contingencies	22	25
Oil, natural gas and NGL depreciation, depletion and amortization	271	684
Depreciation and amortization of other assets	29	35
Impairment of oil and natural gas properties	853	4,976
Impairments of fixed assets and other	38	4
Net (gains) losses on sales of fixed assets	(4)	3
Total Operating Expenses	2,905	8,258
LOSS FROM OPERATIONS	(952)	(5,040)
OTHER INCOME (EXPENSE):		
Interest expense	(62)	(51)
Losses on investments	—	(7)
Loss on sale of investment	(10)	—
Gains on purchases or exchanges of debt	100	—
Other income	3	6
Total Other Income (Expense)	31	(52)
LOSS BEFORE INCOME TAXES	(921)	(5,092)
INCOME TAX BENEFIT:		
Current income taxes	—	—
Deferred income taxes	—	(1,372)
Total Income Tax Benefit	—	(1,372)
NET LOSS	(921)	(3,720)
Net income attributable to noncontrolling interests	—	(19)
NET LOSS ATTRIBUTABLE TO CHESAPEAKE	(921)	(3,739)
Preferred stock dividends	(43)	(43)
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS	\$(964)	\$(3,782)
LOSS PER COMMON SHARE:		
Basic	\$(1.44)	\$(5.72)

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Diluted		\$(1.44)	\$(5.72)
CASH DIVIDEND DECLARED PER COMMON SHARE		\$—	\$0.0875
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (in millions):			
Basic	668	661	
Diluted	668	661	

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (Unaudited)

	Three Months Ended March 31,	
	2016	2015
	(\$ in millions)	
NET LOSS	\$(921)	\$(3,720)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAX:		
Unrealized gains (losses) on derivative instruments, net of income tax expense (benefit) of (\$3) and (\$1)	(4)	(1)
Reclassification of (gains) losses on settled derivative instruments, net of income tax expense (benefit) of \$7 and \$7	4	10
Other Comprehensive Income	—	9
COMPREHENSIVE LOSS	(921)	(3,711)
COMPREHENSIVE INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	—	(19)
COMPREHENSIVE LOSS ATTRIBUTABLE TO CHESAPEAKE	\$(921)	\$(3,730)

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

	Three Months Ended March 31, 2016 2015 (\$ in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET LOSS	\$(921)	\$(3,720)
ADJUSTMENTS TO RECONCILE NET LOSS TO CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Depreciation, depletion and amortization	300	719
Deferred income tax expense (benefit)	—	(1,372)
Derivative gains, net	(201)	(172)
Cash receipts on derivative settlements, net	267	408
Stock-based compensation	12	23
Impairment of oil and natural gas properties	853	4,976
Net (gains) losses on sales of fixed assets	(4)	3
Impairments of fixed assets and other	33	2
Losses on investments	—	7
Loss on sale of investment	10	—
Gains on purchases or exchanges of debt	(100)	—
Restructuring and other termination costs	—	(10)
Provision for legal contingencies	22	25
Other	(8)	(7)
Changes in assets and liabilities	(684)	(459)
Net Cash Provided By (Used In) Operating Activities	(421)	423
CASH FLOWS FROM INVESTING ACTIVITIES:		
Drilling and completion costs	(265)	(1,306)
Acquisitions of proved and unproved properties	(67)	(128)
Proceeds from divestitures of proved and unproved properties	62	21
Additions to other property and equipment	(10)	(58)
Proceeds from sales of other property and equipment	9	2
Additions to investments	—	(1)
Other	(2)	(2)
Net Cash Used In Investing Activities	(273)	(1,472)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash paid to purchase debt	(472)	—
Proceeds from credit facilities borrowings	515	—
Payments on credit facilities borrowings	(148)	—
Cash paid for common stock dividends	—	(59)
Cash paid for preferred stock dividends	—	(43)
Distributions to noncontrolling interest owners	(5)	(29)
Other	(5)	(21)
Net Cash Used In Financing Activities	(115)	(152)
Net decrease in cash and cash equivalents	(809)	(1,201)
Cash and cash equivalents, beginning of period	825	4,108
Cash and cash equivalents, end of period	\$16	\$2,907

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)
 (Unaudited)

Supplemental disclosures to the condensed consolidated statements of cash flows are presented below:

	Three Months Ended March 31, 2016	2015 (\$ in millions)
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, net of capitalized interest	\$39	\$43
Income taxes paid, net of refunds received	\$(19)	\$47
SUPPLEMENTAL DISCLOSURE OF SIGNIFICANT NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Change in accrued drilling and completion costs	\$(9)	\$63
Change in divested proved and unproved properties	\$—	\$(53)
Debt exchanged for common stock	\$77	\$—

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Three Months Ended March 31, 2016 2015 (\$ in millions)	
PREFERRED STOCK:		
Balance, beginning of period	\$3,062	\$3,062
Conversions of 25,802 and 0 shares of preferred stock for common stock	(26)	—
Balance, end of period	3,036	3,062
COMMON STOCK:		
Balance, beginning and end of period	7	7
ADDITIONAL PAID-IN CAPITAL:		
Balance, beginning of period	12,403	12,531
Stock-based compensation	16	12
Exchange of convertible notes for 14,699,368 and 0 shares of common stock	65	—
Exchange of senior notes for 2,555,979 and 0 shares of common stock	11	—
Conversion of preferred stock for 1,021,506 and 0 shares of common stock	26	—
Dividends on common stock	—	(59)
Dividends on preferred stock	—	(43)
Decrease in tax benefit from stock-based compensation	—	(5)
Balance, end of period	12,521	12,436
RETAINED EARNINGS (ACCUMULATED DEFICIT):		
Balance, beginning of period	(13,202)	1,483
Net loss attributable to Chesapeake	(921)	(3,739)
Balance, end of period	(14,123)	(2,256)
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):		
Balance, beginning of period	(99)	(143)
Hedging activity	—	9
Balance, end of period	(99)	(134)
TREASURY STOCK – COMMON:		
Balance, beginning of period	(33)	(37)
Purchase of 10,100 and 12,401 shares for company benefit plans	—	—
Release of 63,318 and 41,046 shares from company benefit plans	2	—
Balance, end of period	(31)	(37)
TOTAL CHESAPEAKE STOCKHOLDERS' EQUITY	1,311	13,078
NONCONTROLLING INTERESTS:		
Balance, beginning of period	259	1,302
Net income attributable to noncontrolling interests	—	19
Distributions to noncontrolling interest owners	1	(26)
Balance, end of period	260	1,295
TOTAL EQUITY	\$1,571	\$14,373

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Chesapeake Energy Corporation ("Chesapeake" or the "Company") and its subsidiaries were prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and include the accounts of our direct and indirect wholly owned subsidiaries and entities in which Chesapeake has a controlling financial interest. Intercompany accounts and balances have been eliminated. These financial statements were prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all disclosures required for financial statements prepared in conformity with U.S. GAAP. This Form 10-Q relates to the three months ended March 31, 2016 (the "Current Quarter") and the three months ended March 31, 2015 (the "Prior Quarter"). Chesapeake's annual report on Form 10-K for the year ended December 31, 2015 ("2015 Form 10-K") includes certain definitions and a summary of significant accounting policies and should be read in conjunction with this Form 10-Q. All material adjustments (consisting solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair statement of the results for the interim periods have been reflected. The results for the Current Quarter are not necessarily indicative of the results to be expected for the full year.

Risks and Uncertainties

Chesapeake's strategy for 2016 is to focus on improving liquidity and generating cash. Our ability to grow, make capital expenditures and service our debt depends primarily upon the prices we receive for the oil, natural gas and natural gas liquids (NGL) we sell. Substantial expenditures are required to replace reserves, sustain production and fund our business plans. Historically, oil and natural gas prices have been very volatile, and may be subject to wide fluctuations in the future. The substantial decline in oil, natural gas and NGL prices from 2014 levels has negatively affected the amount of cash we have available for capital expenditures and debt service.

In the Current Quarter, our capitalized costs of oil and natural gas properties exceeded our full cost ceiling, resulting in a noncash impairment in the carrying value of our oil and natural gas properties of \$853 million, which was the primary driver of our net loss in the Current Quarter of \$921 million. Based on the first-day-of-the-month prices we have received over the 11 months ended May 1, 2016, as well as the current strip price for June 2016, we expect to record downward reserve revisions and another material write-down in the carrying value of our oil and natural gas properties in the second quarter of 2016. Further material write-downs in subsequent quarters will occur if the trailing 12-month commodity prices continue to fall as compared to the commodity prices used in prior quarters.

As of March 31, 2016, we had a cash balance of approximately \$16 million compared to \$825 million as of December 31, 2015, and we had a net working capital deficit of approximately \$1.341 billion compared to a net working capital deficit of approximately \$1.205 billion as of December 31, 2015. Based on our cash balance, forecasted cash flows from operating activities and availability under our revolving credit facility, we expect to be able to fund our planned capital expenditures budget, meet our debt service requirements and fund our other commitments and obligations for the next 12 months. Oil, natural gas and NGL prices have a material impact on our financial position, results of operations, cash flows and quantities of reserves that may be economically produced. If depressed prices persist throughout 2017 and we are unable to restructure or refinance our debt or generate additional liquidity through other actions, our ability to comply with the financial covenants under our revolving credit facility and make scheduled debt payments could be adversely impacted.

In April 2016, we further amended our revolving credit facility agreement. Pursuant to the amendment, our borrowing base was reaffirmed in the amount of \$4.0 billion and our next scheduled borrowing base redetermination date was

postponed until June 15, 2017, with the consenting lenders agreeing not to exercise their interim redetermination right prior to that date. The amendment also modifies the credit agreement to provide for, among other things, (i) the suspension or modification of certain financial covenants and (ii) the granting of liens and security interests on substantially all of our assets, including mortgages encumbering 90% of our proved oil and gas properties that constitute borrowing base properties, all hedge contracts and personal property, subject to certain agreed upon carve outs. See Note 3 for further discussion of our revolving credit facility.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

As of March 31, 2016, we had approximately \$9.425 billion principal amount of debt outstanding, of which \$1.625 billion matures or can be put to us in 2017 (including \$344 million of maturities in January 2017, \$902 million which can be put to us in May 2017 and \$379 million that matures in August 2017) and \$878 million that matures or can be put to us in 2018. See Note 3 for further discussion of our debt obligations, including principal and carrying amounts of our notes. As of March 31, 2016, we had \$367 million of outstanding borrowings under our revolving credit facility.

As operator of a substantial portion of our oil and natural gas properties under development, we have significant control and flexibility over the development plan and the associated timing, enabling us to reduce at least a portion of our capital spending as needed. We have reduced our budgeted 2016 capital expenditures, inclusive of capitalized interest, to \$1.3 - \$1.8 billion, a significant reduction from our 2015 capital spending level of \$3.6 billion. We currently plan to use cash flows from operations, cash on hand and our revolving credit facility to fund our capital expenditures during 2016. We expect to generate additional liquidity with proceeds from potential sales of assets that we determine do not fit our strategic priorities. Management continues to review operational plans for the remainder of 2016 and beyond, which could result in changes to projected capital expenditures and revenues from sales of oil, natural gas and NGL. We closely monitor the amounts and timing of our sources and uses of funds, particularly as they affect our ability to maintain compliance with the financial covenants of our revolving credit facility.

Since December 2015, Moody's Investor Services, Inc. has lowered our senior unsecured credit rating from "Ba3" to "Caa3", and Standard & Poor's Rating Services has lowered our senior unsecured credit rating from "BB-" to "CC". Some of our counterparties have requested or required us to post collateral as financial assurance of our performance under certain contractual arrangements, such as gathering, processing, transportation and hedging agreements. As of May 3, 2016, we have received requests to post approximately \$281 million in collateral under such arrangements, of which we have posted approximately \$247 million (excluding the supersedeas bond with respect to the 6.775% Senior Notes due 2019 (the 2019 Notes) litigation discussed in Note 4). We have posted the required collateral, primarily in the form of letters of credit and cash, or are otherwise complying with these contractual requests for collateral. We may be requested or required by other counterparties to post additional collateral in an aggregate amount of approximately \$696 million, which may be in the form of additional letters of credit, cash or other acceptable collateral. However, we have substantial long-term business relationships with each of these counterparties, and we may be able to mitigate any collateral requests through ongoing business arrangements and by offsetting amounts that the counterparty owes us. Any posting of additional collateral consisting of cash or letters of credit, which would reduce availability under our credit facility, will negatively impact our liquidity.

We may seek to access the capital markets to refinance a portion of our outstanding indebtedness and improve our liquidity. We have historically used the debt capital markets, our most efficient method of raising capital, to supplement our liquidity needs. However, access to funds obtained through the high-yield debt market, particularly in the energy sector, has been severely constrained by a variety of market factors that could hinder our ability to raise new capital. We do not believe the high-yield debt market is currently accessible to us at favorable terms, and our accessibility may not improve during the remainder of 2016.

We have taken measures to mitigate the risks and uncertainties facing us for the next 12 months, including mitigating a portion of our downside exposure to lower commodity prices through derivative contracts, the suspension of payment of dividends on our convertible preferred stock and the April 2016 amendment to our revolving credit facility; however, there can be no assurance that these measures will satisfy our needs. Further, our ability to generate operating cash flow in the current commodity price environment, sell assets, access capital markets or take any other action to improve our liquidity and manage our debt is subject to the risks discussed above and the other risks and

uncertainties that exist in our industry, some of which we may not be able to anticipate at this time or control. If commodity prices decrease, or if we fail to complete significant asset sales, access the capital markets on favorable terms or take other actions to improve our liquidity, we may not be able to fund budgeted capital expenditures or meet our debt service requirements in 2017 or beyond.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(Unaudited)

Reclassifications

In April 2015, the Financial Accounting Standards Board (FASB) issued guidance that requires debt issuance costs to be presented in the balance sheet as a direct deduction from the associated debt liability. This standard requires retrospective application and is effective for annual reporting periods beginning after December 15, 2015. This change in accounting principle is preferable since it allows debt issuance costs and debt issuance discounts to be presented similarly in the consolidated balance sheets as a reduction to the face amount of our debt balances. A retrospective change to our consolidated balance sheet as of December 31, 2015, as previously presented, is required pursuant to the guidance. The retrospective adjustment to the December 31, 2015 consolidated balance sheet is shown below.