Guidance Note on Accounting for Oil and Gas Producing Activities
(for entities to whom Ind AS is applicable)

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi
The Indian economy has performed robustly over the last few years. This speedy economic growth has led to a major increase in demand for crude oil and natural gas, to the extent that India is currently the sixth largest consumer of oil and gas. Upstream oil and gas activity in India has substantially grown post liberalization. As India imports about two-thirds of its crude oil requirement, acquisition, exploration, development and production of oil and gas is critical for India’s energy security and economic growth.

The roadmap issued by the Ministry of Corporate Affairs (MCA) for the adoption of Ind-AS converged with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) are expected to upgrade corporate financial reporting in India to that of other developed economies. Furthermore, it will also fortify India’s move towards strong corporate governance practices, to the global community. India is converging to IFRS in a phased manner – effective April 1, 2016, for larger companies having a net worth equal to or exceeding 500 crore INR and then subsequently for other companies. With the advent of Ind AS there is an acute need for formulation of Guidance Notes in relation to companies applying Ind AS in preparation and presentation of financial statements.

I am pleased that the Research Committee of the Institute of Chartered Accountants of India (ICAI) has formulated this Guidance Note on Accounting for Oil and Gas Producing Activities (Ind AS), for entities whose financial statements have been prepared and presented in accordance with Ind AS, to establish sound accounting principles related to acquisition, exploration, development and production activities.

I wish to place on record my deep appreciation of the efforts put in by CA. Sanjiv K. Chaudhary, Chairman, CA. (Dr.) Debashis Mitra, Vice Chairman and other members of the Research Committee who have made invaluable contribution in the formulation of this Guidance Note.

I am confident that this Guidance Note would be extremely helpful not only to the members but also to others concerned.

New Delhi   CA. M. Devaraja Reddy
December 6, 2016   President, ICAI
Oil and gas sector is of strategic importance and plays a significant role in influencing decisions of all other spheres of the economy. Our growing economy and growth in population still are the main drivers, for increasing oil and gas demand every year.

Realising the need to provide specific guidance for entities in this sector, the Research Committee, in the past, has formulated a Guidance Note on Accounting for Oil and Gas Producing Activities. In the Indian Accounting Standard (Ind AS) scenario, though Ind AS 106 Exploration for and Evaluation of Mineral Resources provides guidance for the exploration and evaluation phase of the upstream oil and gas industry, a need was felt for formulation of Guidance Note to provide guidance to the companies whose financial statements have been prepared and presented in accordance with Ind AS. Accordingly, a Study Group was constituted for the purpose of formulation of the Guidance Note on Accounting for Oil and Gas Producing Activities (Ind AS). This Study Group included representatives of various companies engaged in the upstream oil and gas activities, representative of Comptroller & Auditor General (C&AG), industry association as well as practising Chartered Accountants. The Study Group met more than once to finalise the draft for the consideration of the Committee. The Committee considered the draft and decided to issue it as an Exposure Draft for public comments for a period of atleast 30 days. The Exposure Draft was also sent for comments to various entities engaged in upstream oil and gas activities, members of the Institute as well as the Regional Councils and Branches of the Institute for their views and suggestions. The comments received were considered at a meeting of the Research Committee and the draft was revised accordingly. The Guidance Note, so revised on the basis of deliberations, was then placed for the consideration of the Council and after its approval, is issued under the authority of the Council.

The Guidance Note formulated in accordance with Ind AS continues to deal with the accounting of upstream oil and gas operations viz., acquisition, exploration, development and production activities. It is, thus, a comprehensive guidance for all the four phases of the upstream oil and gas operations also termed as the Exploration and Production (E&P) industry. The Guidance Note provides guidance in accordance with the principles contained in Ind AS. It includes guidance on what constitute oil and gas
assets for the purpose of applying unit of production (UOP) method, accounting for abandonment costs in accordance with principles laid down in Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. The guidance on testing for impairment of exploration and evaluation assets is provided in accordance with the principles laid down in Ind AS 106 while that for development and production assets is in accordance with Ind AS 36, Impairment of Assets. It also includes guidance on accounting for interests in joint ventures in accordance with Ind AS 111, Joint Arrangements, since many entities engaged in upstream oil and gas operations enter into joint venture agreements. Further, E & P entities often undertake transactions in different currencies and accordingly, guidance for determination of functional currency in accordance with the principles laid down in Ind AS 21, The Effects of Changes in Foreign Exchange Rates is also contained in the Guidance Note. It also includes guidance on presentation and certain additional disclosures to be made by an upstream oil and gas entity.

This Guidance Note comes into effect in respect of accounting periods commencing on or after 1 April 2017; its earlier application is encouraged.

I take this opportunity to place on record my deep appreciation of my colleagues CA. Kaushal Kishore and CA. Ashish Bansal, who prepared the basic draft of this Guidance Note. I am also thankful to other members of the Study Group for giving their invaluable comments and suggestions during formulation of the Guidance Note. I would like to thank CA. M. Devaraja Reddy, President, ICAI, CA. Nilesh S. Vikamsey, Vice President, ICAI, CA. (Dr.) Debashis Mitra, Vice-Chairman, Research Committee as well as other members of the Research Committee and my esteemed colleagues in the Council for their contribution in finalisation of the Guidance Note. I would also like to thank CA Deepali Garg and CA. Amit Agarwal, working in the Secretariat of the Research Committee for their support.

I trust this Guidance Note would be very useful to the members of the Institute and others interested in the subject.

New Delhi
December 6, 2016
CA. Sanjiv K. Chaudhary
Chairman, Research Committee
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(The following is the text of the Guidance Note on Accounting for Oil and Gas Producing Activities, issued by the Council of the Institute of Chartered Accountants of India for entities to whom Ind AS are applicable.)

Introduction

1. Oil and gas producing industry, which is extractive in nature, involves activities relating to acquisition of mineral interests in properties, exploration (including prospecting), development and production of oil and gas. Oil and gas also include coal bed methane (CBM) and shale gas. These activities may be carried out onshore or offshore. The aforesaid activities are collectively referred to as upstream operations and form the ‘Upstream Petroleum Industry’. The industry is commonly referred to as the Exploration and Production (E&P) industry. The peculiar nature of the industry requires establishment of industry-specific accounting principles in relation to expense recognition, measurement, presentation and disclosure.

Objective

2. Considering the peculiar nature of E&P industry, Indian Accounting Standard (Ind AS) 16, Property, Plant and Equipment, and Ind AS 38, Intangible Assets, do not apply to recognition and measurement of exploration and evaluation assets [para 3(c) of Ind AS 16 and para 2 (c) of Ind AS 38 respectively]. Ind AS 106, Exploration for and Evaluation of Mineral Resources, applies to such assets.

3. The objective of this Guidance Note is to provide guidance on the accounting principles contained in Ind ASs to accounting for costs incurred on activities relating to acquisition of interests in properties, exploration, development and production of oil and gas.

Scope

4. This Guidance Note applies to costs incurred on acquisition of mineral interests in properties, exploration, development and production of oil and
gas activities, i.e., upstream operations. This Guidance Note also deals with other accounting aspects such as accounting for abandonment costs and impairment of assets that are peculiar to the entities carrying on oil and gas producing activities. It does not address accounting and reporting issues relating to the transporting, refining and marketing of oil and gas. This Guidance Note also does not apply to accounting for:

(i) activities relating to the production of natural resources other than oil and gas; and

(ii) the production of geothermal resources or the extraction of hydrocarbons as a by-product of the production of geothermal and associated resources.

Definitions

5. For the purpose of this Guidance Note, the following terms are used with the meanings specified:

(i) **Appraisal Well**: A well drilled as part of an appraisal drilling programme, which is carried out to determine the physical extent of oil and gas reserves and likely production rate of a field.

(ii) **Depreciation**: Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Depreciation includes amortisation of assets whose useful life is predetermined. Depreciation also includes ‘depletion’ of natural resources through the process of extraction or use.

(iii) **Development Well**: A well drilled, deepened, completed or re-completed within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.

(iv) **Exploratory Well**: An exploratory well is a well drilled to find a new field or to find a new reservoir in a field previously found to be productive of oil or gas in another reservoir. Generally, an exploratory well is any well that is not a development well, a service well, or a stratigraphic test well, as those items are defined separately.

(v) **Exploration and evaluation assets**: Exploration and evaluation expenditures recognised as assets in accordance with the entity’s accounting policy.

(vi) **Exploration and evaluation expenditures**: Expenditures incurred by an entity in connection with the exploration for and evaluation of mineral
resources before the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

(vii)  *Exploration for and evaluation of mineral resources*: The search for mineral resources, including minerals, oil, natural gas and similar non-regenerative resources after the entity has obtained legal rights to explore in a specific area, as well as the determination of the technical feasibility and commercial viability of extracting the mineral resource.

(viii)  *Field*: An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition. There may be two or more reservoirs in a field which are separated vertically by intervening impervious strata, or laterally by local geologic barriers, or by both. Reservoirs that are associated by being in overlapping or adjacent fields may be treated as a single or common operational field. The geological terms ‘structural feature’ and ‘stratigraphic condition’ are intended to identify localised geological features as opposed to the broader terms of basins, trends, provinces, plays, areas-of-interest, etc.

(ix)  *Oil and Gas Reserves:*

(a)  Oil and gas reserves are estimated remaining quantities of oil and gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and gas or related substances to market, and all permissions and financing required to implement the project.

(b)  All oil and gas reserve estimates involve some degree of uncertainty. Uncertainty depends chiefly on availability of reliable geological and engineering data at the time of the estimate and interpretation of data.

(c)  The term economically producible, as it relates to a resource, means a resource which generates revenue that exceeds, or is reasonably expected to exceed, the costs of the operation.

(d)  Based on relative degree of uncertainty, oil and gas reserves can be classified as ‘Proved Oil and Gas Reserves’ and ‘Unproved Oil and Gas Reserves’.
Proved Oil and Gas Reserves: Proved oil and gas reserves are those quantities of oil and gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations before the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether the estimate is a deterministic estimate or probabilistic estimate. The project to extract the hydrocarbons must have commenced or the entity must be reasonably certain that it will commence the project within a reasonable time.

Proved oil and gas reserves can be classified as ‘Proved developed oil and gas reserves’ and ‘Proved undeveloped oil and gas reserves’.

Proved Developed Oil and Gas Reserves: Proved developed oil and gas reserves are reserves that can be expected to be recovered:

(a) through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and

(b) through installed extraction equipment and infrastructure operational at the time of the reserve estimate if the extraction is by means not involving a well.

Proved Undeveloped Oil and Gas Reserves:

(a) Proved undeveloped oil and gas reserves are proved reserves that are expected to be recovered from new wells on undeveloped acreage, or from existing wells where a relatively major expenditure is required for recompletion.

(b) Reserves on undeveloped acreage should be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances.

(c) Undrilled locations can be classified as having proved undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within a reasonable time, unless the specific circumstances, justify a longer time.
(d) Under no circumstances should estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, or by other evidence using reliable technology establishing reasonable certainty.

(xiii) **Probable Reserves:** Probable reserves are those additional reserves that are less certain to be recovered than proved reserves but which, together with proved reserves, are as likely as not to be recovered. When deterministic methods are used, it is as likely as not that actual remaining quantities recovered will exceed the sum of estimated proved plus probable reserves. When probabilistic methods are used, there should be at least a 50% probability that the actual quantities recovered will equal or exceed the proved plus probable reserve estimates.

(xiv) **Reservoir:** A porous and permeable underground formation containing a natural accumulation of producible oil or gas that is confined by impermeable rock or water barriers and is individual and separate from other reservoirs.

(xv) **Service Well:** A service well is a well drilled or completed for the purpose of supporting production in an existing field. Wells in this class are drilled for gas injection (natural gas, propane, butane, or flue gas), water injection, steam injection, air injection, polymer injection, salt-water disposal, water supply for injection, observation, or injection for combustion.

(xvi) **Stratigraphic Test Well:** A stratigraphic test is a drilling effort, geologically directed, to obtain information pertaining to a specific geologic condition. Such wells customarily are drilled without the intention of being completed for hydrocarbon production. This classification also includes tests identified as core tests and all types of expendable holes related to hydrocarbon exploration. Stratigraphic test wells (sometimes called expendable wells) are classified as follows:

(a) **Exploratory-type stratigraphic test well:** A stratigraphic test well drilled, but not in a proved area. These wells are more like
exploratory wells than like geological and geophysical (G&G) activities, even though these wells cannot be used to produce the reserves.

(xvii) Development-type stratigraphic test well: A stratigraphic test well drilled in a proved area.

(xviii) Unit of Production (UOP) method: The method of depreciation (depletion) under which depreciation (depletion) is calculated on the basis of the number of production or similar units expected to be obtained from the asset by the entity.

6. The glossary of certain other terms commonly used in E&P industry and relevant for the Guidance Note is given in Appendix 1.

Classification of Activities and Related Costs

Acquisition Activities

7. Activities carried out by an E&P entity towards the acquisition of right(s) to explore, develop and produce oil and gas, constitute acquisition activities. Once the areas of oil and gas finds are identified, the E&P entity approaches the owner who owns the rights for the exploration, development and production of the underground minerals in respect of the property or area. In order to undertake surveys and exploration activities, an E&P entity has to first obtain a Petroleum Exploration License (PEL) or Letter of Authority (LOA) in India or similar permit elsewhere, by whatever name called. For engaging in development and production activities, an entity has to obtain a Mining Lease (ML) in India. Similarly, other countries may require specific permissions/lease/license for the purpose. The rights for exploration, development or production may also be acquired by entering into a farm-in arrangement (transfer of part of oil & gas interest between parties).

Acquisition Costs

8. Acquisition costs cover all costs incurred to purchase, lease or otherwise acquire a property or mineral right proved or unproved. These include lease/signature bonus, brokers’ fees, legal costs, cost of temporary occupation of the land including crop compensation paid to farmers, consideration for farm-in arrangements and all other directly attributable costs which are incurred in acquiring these rights. These are costs incurred in acquiring the right to explore, drill and produce oil and gas including the initial costs incurred for obtaining the PEL/LOA and ML. Annual licence fees
are excluded. In case the acquisition cost pertains to more than one field, it should be apportioned to the related field on a fair and reasonable basis.

9. Expenditure incurred before an entity has obtained the right(s) to explore, develop and produce oil and gas, i.e., the pre-acquisition costs, e.g., data collection and analysis costs incurred for the purpose of identifying the oil and gas asset to be acquired, are not included in acquisition costs. Such costs are accounted for in accordance with the general principles laid down in the framework for preparation and presentation of financial statements and other applicable accounting pronouncements.

**Activities relating to exploration for and evaluation of mineral resources**

10. Exploration and evaluation activities cover the prospecting activities conducted in the search for oil and gas after an entity has obtained legal right to explore a specific area, as well as activities towards determination of the technical feasibility and commercial viability of extracting the oil and gas. In the course of an appraisal programme these activities include but are not limited to aerial, geological, geophysical, geochemical, palaeontological, palynological, topographical and seismic surveys, analysis, studies and their interpretation, investigations relating to the subsurface geology including structural test drilling, exploratory type stratigraphic test drilling, drilling of exploration and appraisal wells and other related activities such as surveying, drill site preparation and all work necessarily connected therewith for the purpose of oil and gas exploration.

**Exploration and evaluation costs**

11. Principal types of exploration and evaluation costs cover all directly attributable expenditure. General and administrative costs are included in the exploration and evaluation cost only to the extent that those costs can be directly attributable to the related exploration and evaluation assets. In all other cases, these costs are expensed as incurred. For example, general and administrative costs such as directors’ fees, secretarial and share registry expenses, salaries and other expenses of general management, etc., are usually recognised as expenses when incurred. Exploration and evaluation costs include depreciation and applicable operating costs of related support equipment and facilities and other costs of exploration and evaluation activities that are:

(i) costs of surveys and studies mentioned in paragraph 10 above, rights