HMRC - OT02086 - The Full Costs Accounting Method

This is defined in the SORP as:

“A method of accounting for oil and gas exploration and development activities whereby all costs associated with exploring for and developing oil and gas reserves are capitalised, irrespective of the success or failure of specific parts of the overall exploration activity. Costs are accumulated in cost centres known as “cost pools” and the costs in each cost pool are written off against income arising from production of the reserves attributable to that pool”.

The SORP defines a cost pool as:

geological area,

interdependence of infrastructure,

common economic environment,

common development of markets.”

Selection of appropriate cost pools is important and paragraph 41 of the SORP gives examples of acceptable cost pools which maybe on a geographic, regional or country basis.

Paragraph 41 states that:

“all expenditure on pre-licence, licence acquisition, exploration, appraisal and development activities, including enhanced oil recovery and extended life projects expenditures, should be capitalised”.

All other costs, in accordance with FRS 15 Tangible Fixed Assets, should be expensed as incurred, including operating and production-related costs, such as tariffs and royalties, and also administrative and other general overhead costs not directly attributable to the activities referred to in paragraph 41 of the SORP.

All capitalised expenditure should be recorded within an appropriate cost pool when incurred, but pre-licence, licence acquisition, exploration and appraisal costs, of individual licence interests are permitted to be held outside a cost pool until the existence or otherwise of commercial reserves is established.

If this alternative is adopted it means that these costs will not be depreciated pending field determination, subject to there being no evidence of impairment.

Impairment

Paragraph 45 provides that costs initially held outside cost pools must be transferred to the relevant pool, and depreciated:

where there are indications of impairment; all expenditure must be subject to a test for impairment at least annually. Costs that are capitalised pending determination of the presence of commercial reserves, where accounted for in accordance with the SORP are specifically exempt from detailed rules for assessing impairment set out in FRS 11.

At the conclusion of an appraisal programme the possibility of impairment must be considered if; in the case of licence acquisition costs; there is no drilling after one year or; in the case of successful exploration wells requiring further appraisal; such appraisal does not take place within two years of the discovery being made.

Disclosure

Full cost companies must disclose:

the aggregate net book value of full cost pools, which should be classified as “tangible assets”, and

the aggregate of costs held outside cost pools (if any), which should be classified as “intangible assets - exploration expenditure”.

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