

Query No. 3

Subject: Accounting for decommissioning provision for oil and gas assets.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the company’) is engaged in exploration, development and production of crude oil, natural gas and value added products. The company, in course of its business, primarily undertakes drilling of exploratory and development wells. All exploration and evaluation costs incurred in drilling and equipping exploratory and appraisal wells, are initially capitalised as ‘Intangible assets under development - Exploratory Wells in Progress’ till the time these are either transferred to oil and gas assets on completion or expensed as exploration and evaluation cost (including allocated depreciation) as and when determined to be dry or of no further use, as the case may be. In case of abandonment / relinquishment of ‘Intangible Assets under development - exploratory wells in progress’, such costs are written off.

2. The querist has stated that a well drilled within the proved area of an oil and gas reservoir to the depth of a horizon known to be productive is called a development well and all costs relating to development are initially accounted for as ‘oil and gas assets under development - development wells in progress’. Such costs are capitalised by transferring to oil and gas assets when a well is ready to commence commercial production.

3. Oil and gas assets are stated at historical cost less accumulated depletion and impairment losses. These are created in respect of an area / field having proved developed oil and gas reserves, when the well in the area / field is ready to commence commercial production. Cost of temporary occupation of land, successful exploratory wells, all development wells (including service wells), and allied facilities, depreciation on support equipment used for drilling and estimated future decommissioning costs are capitalised and classified as oil and gas assets.

4. Abandonment costs (or decommissioning costs) are the costs incurred on discontinuation of all operations and surrendering the property back to the owner. These costs relate to plugging and abandoning of wells; dismantling of wellheads, production and transport facilities; and for restoration of producing areas in accordance with license requirements, and the relevant legislations and adopted practices.

5. Till the financial year (F.Y.) 1998-99, there was no specific guidance on accounting for abandonment liability, and all expenditure relating to abandonment of well sites or allied facilities was charged to profit and loss account on actual expenditure basis. The wells and allied facilities were capitalised under two heads, expenditure and depreciation, which together formed oil and gas assets.

6. On the basis of recommendations of International Maritime Organization (IMO) Guidelines that all abandoned or disused installations or structures emplaced on the seabed on or after 1st January 1998, standing in less than 100 m of water and weighing less than 4,000 tonnes in air, excluding the deck and superstructure, should be entirely removed. A committee was constituted by the company which submitted its first report in the year 1999 on various removal and disposal options for abandonment and accordingly, from F.Y. 1999-2000, the company started providing for abandonment liability towards offshore well sites based on the technical assessment. Wells which were likely to be

¹ Opinion finalised by the Committee on 16.3.2020.

abandoned during next fifteen years were provided equally over the remaining useful life of such properties. The abandonment of onshore well sites was accounted for in the year in which such cost was incurred.

7. In July 2002, multidisciplinary committee was formed by the company to review and update the previous committee's report; the committee submitted its report in March 2003 as per its recommendations. From F.Y. 2002-03, abandonment liability towards offshore wells sites along with allied facilities was provided for on the basis of the latest technical assessment available with the company. Whereas there was no change in the accounting for abandonment liability of onshore well sites and the abandonment of onshore well sites was accounted for in the year in which such cost was incurred.

8. The querist has stated that the Institute of Chartered Accountants of India (ICAI) issued Guidance Note on Accounting for Oil and Gas Producing Activities (Issued 2003), which provided the following guidance on accounting for abandonment cost for the first time:

“54. The full eventual liability for abandonment cost net of salvage values should be recognised at the outset on the ground that a liability to remove an installation exists the moment it is installed. Thus, an enterprise should capitalise as part of the cost centre the amount of provision required to be created for subsequent abandonment. Charge for abandonment costs should not be discounted to its present value. The provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, industry practice, etc.

55. No gain or loss should be recognized if only an individual well or individual item of equipment is abandoned as long as the remainder of the wells in the cost centre continue to produce oil or gas. Instead, the asset being abandoned be deemed to be fully depreciated. When the last well on the cost centre ceases to produce and the entire cost centre is abandoned, gain or loss should be recognised.”

“43. Depreciation base of the cost centre should include

- (a) Gross block of the cost centre (excluding acquisition costs)
- (b) Estimated dismantlement *and abandonment costs net of estimated salvage* values pertaining to proved developed oil and gas reserves and should be reduced by the accumulated depreciation and any accumulated impairment charge of the cost centre.”

(Emphasis supplied by the querist.)

9. The querist has further stated that from F.Y. 2003-04 to F.Y. 2008-09, based on the initial technical assessment, offshore well sites and allied facilities had huge abandonment cost but salvage value was negligible whereas, onshore wells and allied facilities had lesser abandonment cost than the salvage value. Accordingly, as per the requirements of the Guidance Note and technical assessment, the company recognised abandonment cost (net of salvage value) of offshore well site and allied facilities at initial stage and depreciated such abandonment cost (net of salvage value) along with other producing properties. Abandonment liability of onshore well site and allied facilities were not recognized at initial stage. Abandonment cost of onshore wells and facilities were charged to profit and loss account on the actual abandonment of the wells and facilities.

10. The company adopted to capture and deplete abandonment cost of offshore well sites separately in the following way under three components, viz., expenditure, depreciation

and abandonment cost net of salvage value.

11. In F.Y. 2009-10, statutory auditors and Comptroller and Auditor General (CAG) audit insisted for review of abandonment policy for onshore sites and allied facilities. Accordingly, a committee was constituted with the members of finance and technical disciplines to ascertain the methodology and liability of existing onshore wells and allied facilities. The committee's report suggested that onshore well sites had considerable abandonment cost and its salvage value was lesser than its abandonment cost whereas the abandonment cost of onshore facilities was lesser than the salvage value.

12. Accordingly, from F.Y. 2009-10 to 2012-13, the company started providing for abandonment cost (net of salvage value) of onshore well site at initial stage and depreciated such abandonment cost (net of salvage value) along with oil and gas assets. Whereas the abandonment costs of onshore facilities were accounted for in the year in which such costs were incurred as the salvage value was expected to take care of the abandonment costs. The abandonment cost on dry well was expensed as exploratory well cost.

13. The ICAI revised Guidance Note on Accounting for Oil and Gas Producing Activities in 2013, which provided following guidance on accounting for abandonment cost:

“36. The full eventual liability for abandonment cost should be recognised when the obligation arises, on the ground that a liability to remove an installation exists the moment it is installed. Thus, an enterprise should capitalise as part of the cost centre the amount of provision required to be created for subsequent abandonment. Charge for abandonment costs should not be discounted to its present value. The provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, industry practice, etc.

Changes in the measurement of existing abandonment costs that result from changes in the estimated amount of the outflow of resources embodying economic benefits required to settle the obligation should be added to, or deducted from the related cost center in the current period and would be considered for necessary depletion (depreciation) prospectively.

Abandonment of Properties

37. No gain or loss should be recognised if only an individual well or individual item of equipment is abandoned as long as the remainder of the wells in the cost centre continues to produce oil or gas. When the last well on the cost centre ceases to produce and the entire cost centre is abandoned, gain or loss should be recognised.”

“31. The depreciation base of the cost centre should include

- a. Gross block of the cost centre;
- b. The estimated future expenditure (based on current costs) to be incurred in developing the proved oil and gas reserves referred to in paragraph 32;
- c. Estimated dismantlement and abandonment costs net of estimated salvage values (refer to paragraphs 35-36) for facilities set up for developing the proved oil and gas reserves referred to in paragraph 32;

and should be reduced by the accumulated depreciation and any accumulated impairment charge of the cost centre.”

As per the revised Guidance Note 2013, full abandonment provisions were recognised to the respective assets. Earlier, abandonment cost (net of salvage value) used to be recognised but revised Guidance Note dropped the word ‘*net of salvage value*’ from the cost. This cost should be considered at current prices and need not be fair valued. Any subsequent change in the abandonment cost was required to be adjusted with the related assets and would be depreciated prospectively. Paragraph 31 of the Guidance Note specifically states that, while calculating depletion, abandonment cost net of estimated salvage value need to be taken into account.

(Emphasis supplied by the querist.)

14. Accordingly, from *F.Y. 2013-14 to 2015-16*, the company capitalised the full abandonment provision (gross of salvage value) under four components, viz., *Expenditure, Depreciation, Abandonment cost (net) and Salvage Value for all onshore and offshore oil and gas assets*, however, while computing depletion on oil and gas assets, salvage value component was not considered.(Emphasis supplied by the querist.)

15. On notification of Companies (Indian Accounting Standards) Rules, 2015 by Ministry of Corporate Affairs, the ICAI again revised Guidance Note on Accounting for Oil and Gas Producing Activities (Issued 2016) for entities to whom Ind AS is applicable, which provided guidance on accounting for abandonment costs as follows:

“Accounting for Abandonment Costs

33. Abandonment costs are the costs incurred on discontinuation of all operations and surrendering the property back to the owner. These costs relate to plugging and abandoning of wells; dismantling of wellheads; production; and transport facilities and to restoration of producing areas in accordance with license requirements and the relevant legislation.

34. In accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources. Thus, an entity should capitalise as part of property, plant and equipment or intangible asset, as the case may be, the amount of provision required to be created for subsequent abandonment. The provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, industry practice, etc. **Where the effect of the time value of money is material, the amount of the provision should be the present value of the expenditures expected to be required to settle the obligation.** The discount rate (or rates) should be a pre- tax rate (or rates) that reflect current market assessments of the time value of money and the risks specific to the liability. The discount rate should not reflect risks for which future cash flow estimates have been adjusted. **Changes in the measurement of existing abandonment costs** that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation or a change in the discount rate should be added to, or deducted from the related field in the current period and would be considered for necessary depletion (depreciation) prospectively. However, the change in the estimated provision due to the **periodic unwinding of the discount** should be recognized in statement of profit and loss as it occurs. Since

abandonment costs do not reflect borrowed funds, the unwinding cost would not be a borrowing cost eligible for capitalization.

Abandonment of Properties

35. No gain or loss should be recognised if only an individual well or individual item of equipment is abandoned or decided as dry as long as the remainder of the wells in the field continues to produce oil or gas. When the last well on the field ceases to produce and the entire field is abandoned, gain or loss should be recognised.”

“28. Depreciation base of the field should include:

- (i) Gross block of the field (excluding acquisition costs)
- (ii) Estimated, decommissioning and abandonment costs **net of estimated salvage values** pertaining to proved developed oil and gas reserves

and should be reduced by the accumulated depreciation and any accumulated impairment charge of the field.”

(Emphasis supplied by the querist.)

16. Paragraph D21 of Appendix D, ‘Exemptions from other Ind ASs’ to Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’ provides as follows:

“D21 Appendix ‘A’ to Ind AS *16 Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to Ind ASs. If a first-time adopter uses this exemption, it shall:

- (a) measure the liability as at the date of transition to Ind ASs in accordance with Ind AS 37;
- (b) to the extent that the liability is within the scope of Appendix A of Ind AS 16, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk adjusted discount rate(s) that would have applied for that liability over the intervening period; and
- (c) calculate the accumulated depreciation on that amount, as at the date of transition to Ind ASs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity in accordance with Ind ASs.”

17. Under the Previous GAAP, discounting of provisions was not required whereas under Ind AS, provisions are to be measured at discounted amounts, if the effect of time value of money was material. Availing exemption available under paragraph D21, the company measured the decommissioning provision in accordance with Ind AS 37 as at the transition date 01.04.2015 and computed the estimate of the amount that would be included in the cost of related oil and gas assets by discounting the decommissioning provision computed at transition date using the best estimate of historical risk adjusted

discount rate to the date when the liability first arose. Thereafter, the company has computed depletion on oil and gas assets on the estimated amount using unit of production method.

18. Accordingly, the decommissioning provision was estimated and consequently adjustments to oil and gas assets and decommissioning provisions were made on transition to Ind ASs. The company re-measured decommissioning provisions at the transition date by availing the optional exemption as per paragraph D21 of Ind AS 101, 'First-time Adoption of Indian Accounting Standards'. This resulted in decrease in decommissioning provision by Rs. 61,250.20 million. Depletion was charged on the resulting present value from the date that the obligation first arose to the date of transition (on the basis of gross block/accumulated depletion ratio) subject to minimum of the salvage value of the assets as on the transition date. The difference between the written down value of the asset created towards abandonment provision and the amount calculated resulted in decrease in oil and gas assets by Rs. 65,876.14 million. Similarly, CWIP-Development wells in progress decreased by Rs. 259.58 million and CWIP-Other decreased by Rs. 120.00 million as at April 1, 2015.

Similarly, it also resulted in decrease in decommissioning provision by Rs. 88,388.01 million and decrease in oil and gas assets by Rs. 90,955.17 million, other property, plant & equipment by Rs. 187.50 million, CWIP-Development wells in progress by Rs. 34.17 million, CWIP-Others by Rs. 1,222.70 million and Inventory by Rs. 164.89 million as at March 31, 2016. Further, there was also a reduction in transfer from CWIP-Development wells in progress by Rs. 202.66 million.

The net effect of aforesaid changes was decrease in total equity by Rs. 5,005.26 million as at April 1, 2015 and Rs. 4,396.16 million as at March 31, 2016.

For the aforesaid purposes, the salvage value was restricted to the abandonment provision. The capitalised portion of abandonment asset was bifurcated into salvage value and other depletable asset.

19. The querist has reproduced the following paragraphs of Appendix A, 'Changes in Existing Decommissioning, Restoration and Similar Liabilities' to Ind AS 16, 'Property, Plant and Equipment':

- “4 Changes in the measurement of an existing decommissioning, restoration and similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, shall be accounted for in accordance with paragraphs 5–7 below.
- 5 If the related asset is measured using the cost model:
 - (a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the *related asset* in the current period.
 - (b) the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.
 - (c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with Ind

AS 36.”

- “7 The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur. This applies under both the cost model and the revaluation model.
- 8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. Capitalisation under Ind AS 23 is not permitted.”

(Emphasis supplied by the querist.)

20. The Current accounting policy of decommissioning provision has been reproduced by the querist hereunder:

“Decommissioning cost includes cost of restoration. Provision for decommissioning costs is recognized when the Company has a legal or constructive obligation to plug and abandon a well, dismantle and remove a facility or an item of Property, Plant and Equipment and to restore the site on which it is located. The full eventual estimated provision towards costs relating to dismantling, abandoning and restoring well sites and allied facilities are recognized in respective assets when the well is complete / facilities or Property, Plant and Equipment are installed.

The amount recognized is the present value of the estimated future expenditure determined using existing technology at current prices and escalated using appropriate inflation rate till the expected date of decommissioning and discounted up to the reporting date using the appropriate risk free discount rate.

An amount equivalent to the decommissioning provision is recognized along with the cost of exploratory well or Property, Plant and Equipment. The decommissioning cost in respect of dry well is expensed as exploratory well cost.

Any change in the present value of the estimated decommissioning provision other than the periodic unwinding of discount is adjusted to the decommissioning provision and the corresponding carrying value of the related asset. In case reversal of decommissioning provision exceeds the corresponding carrying amount of the related asset, the excess amount is recognized in the Statement of Profit and Loss. The unwinding of discount on provision is charged in the Statement of Profit and Loss as finance cost.

Provision for decommissioning cost in respect of assets under Joint Operations is considered as per participating interest of the Company on the basis of estimates approved by the respective operating committee. Wherever the same are not approved by the respective operating committee, decommissioning cost estimates of the company are considered.”

21. *Estimation of provision for decommissioning*

The company estimates provision for decommissioning as per the principles of Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’ for the future decommissioning of oil and gas assets at the end of their economic lives. Most of these decommissioning activities would be in the future, the exact requirements that may have to be met when the removal events occur are uncertain. Technologies and costs for decommissioning are constantly changing. The timing and amounts of future cash flows are subject to significant uncertainty.

The timing and amount of future expenditures are reviewed at the end of each reporting

period, together with rate of inflation for escalation of current cost estimates and the interest rate used in discounting the cash flows. The economic life of the oil and gas assets is estimated on the basis of long term production profile of the relevant oil and gas asset. The General Consumer Price Index (CPI) for inflation i.e. 4.28% (Previous year 3.81%) has been used for escalation of the current cost estimates and pre-tax discounting rate used to determine the balance sheet obligation as at the end of the year is 7.56% (Previous year 7.12%), which is the risk free government bond rate with 10 year yield.

The abandonment provision is re-estimated annually by calculating the abandonment estimates at current cost and escalated @ CPI inflation and discounted at return on 10 year G- SEC. Any increase in provision is capitalised and decrease was adjusted with the written down value (WDV) of capitalised portion of abandonment provision and where the WDV was zero, the differential provision was taken to the statement of profit and loss. Accordingly, an amount Rs. 6,101.94 million, Rs. 20,048.04 million, Rs. 2,035.64 million, and Rs. 3,510.16 million, has been taken to statement of profit and loss towards excess provision written back in 2015-16, 2016-17, 2017-18 and 2018-19 respectively.

B. Query

22. The Expert Advisory Committee of the ICAI is requested to give opinion on the following queries:

- (a) Whether the company is correct in accounting
 - (i) for increase in decommissioning provision estimates by way of capitalizing with oil and gas assets,
 - (ii) decrease in decommissioning provision estimates as an adjustment to the written down value (WDV) of capitalised portion of abandonment provision, and
 - (iii) where the WDV of capitalised portion of abandonment provision is zero the differential provision is taken to the statement of profit and loss or
- (b) The company should adopt any other accounting treatment?
- (c) If the answer to (b) above is 'yes', whether the suggested accounting treatment will call for retrospective adjustment in the financial statements.

C. Points considered by the Committee

23. The Committee notes that the basic issue raised by the querist relates to accounting for decommissioning obligations arising in respect of removal and restoration expenditure for onshore and offshore wells and other facilities of the company under Indian Accounting Standards. These costs have been, hereinafter, broadly referred to as 'decommissioning costs'. The Committee has, therefore, restricted the opinion only to this issue and has not examined any other issue that may arise from the Facts of the Case, such as, compliance with IMO guidelines, determination/estimation of the removal/ restoration costs and salvage value, the appropriateness of the discount rate used by the company, accounting for decommissioning obligations arising towards removal and restoration under previous GAAP (i.e., before transition to Ind ASs), method used by the company for depreciation and depletion, accounting for exploration and evaluation expenditure, accounting for dry wells, accounting for interest in joint operation, accounting for decommissioning or restoration provision during the production phase, and transition accounting under Ind AS 101 on first time adoption of Ind ASs. Further, the Committee presumes that change in decommissioning liability in the extant case is due to changes in

the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, as covered under Appendix A, 'Changes in Existing Decommissioning, Restoration and Similar Liabilities' to Ind AS 16 and not due to other factors, such as changes in exchange rates, etc. The Committee also wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified by the Companies (Indian Accounting Standards) Rules, 2015 as amended/revised from time to time.

24. The Committee notes that Ind AS 106, 'Exploration for and Evaluation of Mineral Resources', states the following:

“5 An entity shall not apply this Ind AS to expenditures incurred:

- (a) before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.
- (b) after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.”

“11 In accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources.”

The Committee notes that after the technical feasibility and commercial viability of extracting a mineral resource is demonstrated, the accounting for decommissioning and restoration costs is governed by the requirements of Ind AS 37 and Appendix A, 'Changes in Existing Decommissioning Restoration and Similar Liabilities' to Ind AS 16. Further, Guidance Note on Accounting for Oil and Gas Producing Activities (for entities to whom Ind AS is applicable), issued by the ICAI provides guidance, inter alia, for decommissioning and restoration costs incurred in respect of oil and gas producing activities. The Committee notes the requirements of Ind AS 37, Guidance Note and Appendix A as follows:

Ind AS 37

“36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.”

“42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making

judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

- 44 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

Present value

- 45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.**

46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

- 47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted."**

Appendix A to Ind AS 16

“4 Changes in the measurement of an existing decommissioning, restoration and similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, shall be accounted for in accordance with paragraphs 5–7 below.

5 If the related asset is measured using the cost model:

- (a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.
- (b) the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.
- (c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with Ind AS 36.”

“7. The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur. This applies under both the cost model and the revaluation model.

8. The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. Capitalisation under Ind AS 23 is not permitted.”

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

“Accounting for Abandonment Costs

33. Abandonment costs are the costs incurred on discontinuation of all operations and surrendering the property back to the owner. These costs relate to plugging and abandoning of wells; dismantling of wellheads; production; and transport facilities and to restoration of producing areas in accordance with license requirements and the relevant legislation.

34. In accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources. Thus, an entity should capitalise as part of property, plant and equipment or intangible asset, as the case may be, the amount of provision required to be created for subsequent abandonment. The provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, industry practice, etc. Where the effect of the time value of money is material, the amount of the provision should be the present value of the expenditures expected to be required to settle the obligation. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect current market assessments of the time value of money and the risks specific to the liability. The discount rate should not reflect risks for which future cash flow estimates have been adjusted. Changes in the measurement of existing abandonment costs that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation or a change in the discount rate should be added to, or deducted from the related field in the current period and would be considered for necessary depletion (depreciation) prospectively. However, the change in the estimated provision due to the periodic unwinding of the discount should be recognized in statement of profit and loss as it occurs. Since abandonment costs do not reflect borrowed funds, the unwinding cost would not be a borrowing cost eligible for capitalization.

Abandonment of Properties

35. No gain or loss should be recognised if only an individual well or individual item of equipment is abandoned or decided as dry as long as the remainder of the wells in the field continues to produce oil or gas. When the last well on the field ceases to produce and the entire field is abandoned, gain or loss should be recognised.”

The Committee notes from the above that an entity should recognise a decommissioning or restoration provision in respect of the obligation to remove facilities and to restore the environment and that this obligation may arise even before any production takes place. The Committee further notes that the accounting for decommissioning provision will depend on how the related costs have been accounted for. If the related costs are capitalised, the associated decommissioning costs should also be capitalised. However, if the related costs are expensed (such as certain exploration and evaluation costs that do not meet the capitalization criteria under Ind AS 106), any associated decommissioning or

restoration costs should also be expensed. Further, an increase in the decommissioning or restoration provision resulting from revised estimates would result in recognition of an addition to the cost of asset. However, Appendix A to Ind AS 16 specifically states that any addition to an asset as a result of an increase in a decommissioning or restoration provision may be considered to be a trigger for impairment testing. Resultantly, a significant increase in a decommissioning or restoration provision may lead to an immediate impairment of that asset.

Conversely, a decrease in the decommissioning or restoration provision could exceed the carrying amount of the related asset, in which case the excess (after adjusting the entire carrying amount of the related asset and not only to the extent of WDV of the capitalised portion of abandonment provision in the carrying amount of related asset) should be recognised in the statement of profit or loss. The Committee is of the view that as per the requirements of Appendix A to Ind AS 16, an entity reduces the carrying value of the whole asset (comprising its acquisition/ construction cost and decommissioning/abandonment cost) by the reduction in the present value of the decommissioning provision. The Appendix does not treat the decommissioning/abandonment element as a separate component of the asset. Accordingly, it would not be appropriate to recognise any gain until the carrying value of the whole asset is extinguished. Further, the adjusted depreciable amount capitalized is depreciated over the remaining useful life of the asset. Once the related asset has reached the end of its useful life (for example, in cases, where the carrying amount of the asset is zero), all subsequent changes in the decommissioning liability should be recognised in profit or loss as they occur.

25. The Committee notes that Ind AS 37 contains the above-reproduced guidance with regard to the measurement of decommissioning obligation, as per which the amount of provision should be made at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period and where the effect of time value of money is material, the amount of provision should be the present value of the expenditure expected to be required to settle the obligation. The Committee also notes that Ind AS 37 also requires that risk should be taken into account while determining the discount rate in the calculation of a provision. An entity should use a discount rate that reflects current market assessments of the time value of money and the risks specific to the liability (viz., a risk-adjusted rate). Thus, the Committee is of the view that the company in the extant case should adjust risk-free Government securities' rate for the risks specific to the liability, as discussed above.

D. Opinion

26. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 22 above:

- (a) As discussed in paragraph 24 above, an increase in the decommissioning or restoration provision resulting from revised estimates would result in recognition of an addition to the cost of asset. However, a significant increase in a decommissioning or restoration provision may lead to an immediate impairment of that asset. Conversely, a decrease in the decommissioning or restoration provision could exceed the carrying amount of the related asset, in which case the excess (after adjusting the entire carrying amount of the related asset and not only to the extent of WDV of the capitalised portion of abandonment provision in the carrying amount of related asset) should be

recognised in the statement of profit or loss. Further, the adjusted depreciable amount capitalized is depreciated over the remaining useful life of the asset. Once the related asset has reached the end of its useful life (for example, in cases, where the carrying amount of the asset is zero), all subsequent changes in the decommissioning liability should be recognised in profit or loss as they occur.

Further, as discussed in paragraph 25 above, with regard to the measurement of decommissioning obligation, the amount of provision should be made at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period and where the effect of time value of money is material, the amount of provision should be the present value of the expenditure expected to be required to settle the obligation. Furthermore, as Ind AS 37 requires that risk should be taken into account while determining the discount rate in the calculation of a provision, the company should use a discount rate that reflects current market assessments of the time value of money and the risks specific to the liability (viz., a risk-adjusted rate). Thus, the company in the extant case should adjust risk-free Government securities' rate for the risks specific to the liability, as discussed in paragraph 25 above.

- (b) Refer to (a) above.
- (c) To the extent the company's accounting treatment is deviant from that mentioned in paragraphs 26 (a) above, the company shall account for the same in accordance with the requirements of Ind AS 8, 'Accounting Policies, Changes in Estimates and Errors'.
