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Provisions for Oil and Gas Decommissioning Costs: Compliance with Disclosure Requirements by Oil and Gas Companies Listed in the UK

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Abstract

Due to their complications in terms of uncertainty and calculations provisions for oil and gas decommissioning costs are not easy to be understood and interpret by users of no accounting and finance background. Furthermore, due to their significant sizes, cash outflow effect and importance for decision making disclosing more detailed information seem to be ideal requirement to simplify these complications. This study raises, almost for the first time, queries about compliance, sufficiency, uniformity and fairness of oil and gas companies' disclosure practices with regard to provisions for decommissioning costs. In order to provide answers to the research quires, annual reports of 69 oil and gas companies listed in the UK were analysed and thirteen interviews with different professionals were conducted. Our results reveal that whilst there is sufficient standards to regulate accounting for provisions for decommissioning costs there seems to be lack of compliance with requirements of international accounting standards in terms of disclosing information on provisions for decommissioning costs. In many cases, and probably due to their sensitive nature, we found that oil and gas companies tend to disclose a minimum amount of information about provisions for decommissioning costs.

Keywords: Accounting, Decommissioning, Gas, Oil, Provisions, UK

1. INTRODUCTION

Oil and gas decommissioning costs are relatively high. Due to their significance, disclosures of provisions for oil and gas decommissioning costs are of particular importance to stakeholders for decision making. This is because accounting disclosures may be a first point for stakeholders in making investment decisions. Although there seems to be a rich body of literature on accounting disclosures in general, there is a dearth of studies on the decommissioning disclosure requirements and practices of oil and gas companies listed in the UK. The focus of previous academic literature on decommissioning have steered more towards the engineering and technicality of decommissioning oil and gas fields, but there is a lack of studies on the accounting aspect of decommissioning.

This study seeks to explore the usefulness and success of the International Accounting Standards (IAS) and the Statement of Recommended Practices (SORP) in providing a suitable base for accounting for provisions for decommissioning costs of oil and gas installations of oil and gas companies listed in the UK. The study also seeks to explore compliance of oil and gas companies listed in the UK with the disclosure requirements of these standards: IASs and SORP.

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The importance of the disclosure requirements and compliance arise from the fact that stakeholders can learn about companies' activities, policies and application of different regulations and strategies via disclosures for a better decision making. Therefore, this paper is a starting point and a stepping stone for future studies on this and similar topics. This study is timely and should be of particular interest to oil and gas companies, policy makers, accounting standards setters, environmental managers, analysts, other accounting bodies, government economists and tax authorities. The remaining of this paper is organised as follows: conceptualising disclosures of provisions for decommissioning costs; research questions; methodological approach and sampling; analytical approach, analysis and discussion; and conclusion.

2. CONCEPTUALISING DISCLOSURES OF PROVISIONS FOR DECOMMISSIONING COSTS

Oil and gas companies are required to dismantle, remove and restore items of property, plant and equipment (PPE) at the end of their offshore and onshore operations and to remediate any environmental damage they may have caused. These obligations are referred to as "decommissioning"; the Statement of Recommended Practice (OIAC. SORP, Para 88: 2001) defines decommissioning as "the process of plugging and abandoning wells, of dismantlement of wellhead, production and transport facilities and of restoration of producing areas in accordance with licence requirements and the relevant legislation".[1]

Disclosure of information in annual reports is deemed important for a number of reasons: prevention of fraud, protection of investors, accountability of managers to shareholders and corporate governance, efficiency through cost reductions, standardisation of information, ease of comparisons and more importantly as a response to market, social and political pressures (Beck & Toms, 2009; Villiers, 2012). Furthermore, disclosures may be seen as means of establishing and protecting the legitimacy of an organisation as they influence public opinion and public policy (Beck & Toms, 2009). At the same time, disclosing information of relevant issues is seen as part of the agent duties towards the principal: shareholders. On the other hand, Lundholm and Van Winkle (2006) argue that 'no news is bad news' Therefore, companies would prefer to respond to the market and disclose information rather than staying silent, however this depends on the topic of the disclosure (Gibbins et al., 1990).

Berry and Wright (2001) claim that information on oil and gas reserves provide shareholders with data regarding the likelihood of positive future cash flows; thus, affecting the share price and market value of oil and gas companies positively. Following the same line of argument, decommissioning costs, not being a revenue expenditure, can be seen to represent a negative and significant cash outflow which could therefore affect share prices and the market value of oil and gas companies adversely. Consequently, disclosing information about provisions for decommissioning costs is to the benefit of shareholders and potential investors. In support of this point, Johansen and Plenborg (2013: 607) state "Because the demand for these disclosure items is high, we suggest that there is a need to focus on the ways in which disclosures in these areas can be improved". This implies a requirement for standardising disclosures of decommissioning costs by oil and gas companies.

Decommissioning, besides not being revenue expenditure, is associated with cash outflows and an indication of projects' expiry. Therefore, disclosing information about decommissioning costs may be seen as being 'bad news' that may lead to loss of competitive advantage. Therefore, we believe that voluntary disclosure theory does not hold true in the case of provisions for decommissioning costs of oil and gas companies. Nevertheless, if oil and gas companies chose not to disclose decommissioning related information upon expiry of project's life the underlying economic events will reveal themselves in the accounting statements, cash flow and balance sheet, of these companies (PWC, 2008).

Studies on decommissioning costs have tackled the issue from different perspectives: nuclear related decommissioning studies (Mingst, 1980); legal and regulatory perspectives of decommissioning obligations (Aldersey-Williams, 2008); technological and engineering decommissioning alternatives (Day, 2008); disclosure expectation gap (Lawal & Russell, 2011), and economy of decommissioning (Stoke, 2014). None of these studies investigated reasons for not disclosing detailed information on provisions for oil and gas decommissioning costs and none of them reported the level of compliance of disclosures with the requirements of the IASs. Herein comes this study with an objective of exploring compliance of oil and gas companies listed in the UK with disclosure requirements for decommissioning costs and the level of uniformity of these disclosures between companies. Our findings should identify ways in which preparers can improve disclosure quality and quantity in future and standard setters can enhance standards to meet the needs and requirements of users of financial statements.

[1] "The SORP will no longer apply to any entity for accounting periods beginning on or after 1 January 2015 (the deadline for the application of FRS 100-102). However, the SORP is being retained below on the OIAC website as a reference document" (OIAC, 2016: online).

3. RESEARCH QUESTIONS

This research study looks at the compliance levels, of oil and gas companies listed in the UK, with the disclosure requirements of the International Accounting Standards. We identified a number of standards that guide accounting for decommissioning costs: IAS 2, IAS 16, IAS21, IAS 37, IFRIC 1, IFRC 5 and SORP2. Therefore, the study raises the following research questions almost for the first time:

1 To what extent have the International Accounting Standards (IAS2, IAS 16, IAS 21, IAS 37, IFRIC 1, IFRIC5 and SORP) provided a suitable base for accounting for and disclosing of decommissioning costs of the oil and gas industry?
2 To what extent have oil and gas companies listed in the UK been complying with the disclosure requirements of the International Accounting Standards and the SORP with regard to provisions for decommissioning costs?
3 What is the perception of listed oil and gas companies in the UK of the current disclosure practice of information about decommissioning oil and gas installations?

4. METHODOLOGICAL APPROACH AND SAMPLING

This study is an exploratory and explanatory in nature. The exploratory aspect of the study is served by analysing annual reports of the sampled companies and interviews with the study participants. The explanatory aspect of the study would be fulfilled by providing interpretations to the results of the study and offering recommendations when applicable on the best disclosure practices of decommissioning costs. Document analysis, using companies' annual reports and accounts, and interviews are used to explore the current accounting practices and disclosures of the decommissioning costs and what obstacles, suggestions and alternatives may be shared by professionals in oil and gas industry and accounting firms.

Oil and gas producing companies listed on the FTSE All-share and on the UK Alternative Investment Market (AIM) were identified on 20 April 2016. Of these, annual reports of 69 companies were considered suitable for our study. Table 1 presents a summary of our sample companies. In addition to the document analysis, 13 semi-structured in depth interviews were conducted with professionals from different stakeholders groups, table 1 presents a descriptive account of our interviews.

Table 1: Descriptive Statics of Sampled Companies

Criteria	Stock	Location	GAAP
FTSE100	10		
AIM	99		
UKCS		22	
Africa		14	
Europe		9	
Russia		7	
South America		4	
USA		11	
Falklands		2	
India		5	
Central Asia and Caspian		6	
Australia and New Zealand		2	
The Caribbean		2	
Mediterranean basin		3	
Rest of the World		22	
UK GAAP			35
EU GAAP			19
Canadian GAAP			4
Other GAAPs			51
Totals	**109**	**109**	**109**
No revenues and no provisions			40
Companies with complete data			69

[2] The SORP is no longer applicable to any entity since 1 January 2015 (the deadline for the application of FRS 100-102). However, a number of our interviewees state that they still use the SORP as a reference document for their accounting. Therefore, we decided to continue using it in our study.

Table 2: Descriptive Statistics of Interviews

Interview	Organization	Number of Interviewees	Code	Duration of Interview	Date of Interview	Mode of Interview
1	DECC	2	GOV 1a GOV1b	28 minutes	16.05.2016	Telephone
2	Oil and Gas Authority	1	GOV 2	30 minutes	13.05.2016	Telephone
3		1	GOV 3	22 minutes	23.05.2016	Telephone
4	Oil and Gas Industry	1	O&GI 1	37 minutes	21.06.2016	Telephone
5		2	O&GI 2a O&GI 2b	32 minutes	10.06.2016	Telephone
6		1	O&GI 3	52 minutes	16.05.2016	Telephone
7		1	O&GI 4	60 minutes	05.05.2016	Telephone
8		1	O&G I 5	40 minutes	20.05.2016	Face-to-face
9	Academic	1	ACC 1	25 minutes	16.05.2016	Telephone
10		1	ACC 2	25 minutes	03.06.2016	Telephone
11	Independent Consultant	1	CONS 1	31 minutes	15.06.2016	Telephone
12		1	CONS 2	50 minutes	25.05.2016	Face-to-face
13	Auditor	2	AUD 1a AUD 1b	30 minutes	16.06.2016	Telephone

5. ANALYTICAL APPROACH

Content analysis is the main analytical technique that was used in this research. This analytical tool has been widely used in disclosure related studies (Beck & Toms, 2009; Abdo & Al Drugi, 2012; Al Drugi & Abdo, 2014). The quality of decommissioning costs disclosures is measured by the degree of compliance of the reporting entity with the disclosure requirements of the IASs and SORP. The analysis of disclosures extends to assess the quantity of disclosures and whether companies opt to voluntarily disclose other decommissioning related information in their annual reports. The analysis focuses on the variability of disclosures, if any, according to company listing as a possible driver for compliance with disclosures' requirements. This is because it is believed that larger and more profitable companies tend to disclose more information than smaller and less profitable counterparts.

To facilitate the completion of the content analysis, a disclosure requirements list and a checklist have been developed. These are used to record the compliance of the 69 companies sampled. Disclosure requirements were categorised according to the Accounting Standards and SORP. Companies were categorised according to their area of operation and their scale (FTSE main index or AIM).

6. ANALYSIS AND DISCUSSION

An analysis of our self-constructed compliance index reveals that some companies, such as IGAS Energy plc, Egdon Resources plc and BP to name few, do comply with most of the disclosure requirements. However, other companies such as Great Eastern Energy Corporation and Hardy Oil and Gas, both Indian based companies, and most of American based companies, such as Caza oil and Gas plc, EDG Resources Inc and Empyrean Energy to name few, show recognisable less compliance to the disclosure requirements in comparison to their European counterparts. This raises our concern about the adherence to the disclosure requirements of the IASs and SORP in terms of provisions for decommissioning costs.

Of the 69 companies, we found that the majority of the companies, 63, comply with the requirement of the SORP "Disclosure of provisions for decommissioning costs to be separately made under the balance sheet caption 'provisions for liabilities and changes' [SORP, s 203]. However, 6 companies seem not to follow these requirements. Two of these six companies are Russian based, one is Canadian based and the remaining three are North American based. Since the SORP was a UK based standard, it is not surprising to see these companies not complying with this requirement. However, the one that surprised us is actually a North American based company that follow the UK GAAP and not complying with this SORP disclosure requirement, this company is IOFINA Plc. In terms of IAS requirements, our analysis reveals different levels of compliance with the different requirements. This reflects sort of inconsistency and lack of unifying practices among oil and gas companies listed in the UK.

A number of our interviewees (GOV 3, O&GI 1, O&GI 2, O&GI 3) agree that provisions for decommissioning costs are based in most cases on subjective estimates, and preparing provisions for decommissioning costs is in fact a very complicated process. Since provisions for decommissioning costs are based on estimates they may not be very accurate, therefore Interviewee AUD 1 warns that these estimates must be reviewed periodically, and revised estimates must be disclosed to stakeholders. Interviewees (O&GI 3, O&GI 5) argue that understanding decommissioning terminology, rules and best practice is proved to be problematic particularly that oil and gas decommissioning business is new to the UK oil and gas industry. Therefore, accounting for provisions for decommissioning costs and reporting these to stakeholders is not an easy business. In this context, Interviewee O&GI 5 states that there is a standard, IFRIC, which deals with changes in the provisions for decommissioning oil and gas assets, however understanding the requirements of this standard and its interpretations proved not to be easy for financial accountants.

Our interviewees suggest that lack of disclosures of provisions for decommissioning oil and gas assets relates to the many challenges that confront the preparation of such provision. These challenges are estimating the cessation of production point, identifying a timeframe for decommissioning to occur, specifying the technological and financial needs for undertaking decommissioning businesses, and estimating the environmental obligations that may arise as a consequence of decommissioning oil and gas assets, particularly offshore assets. Changes in international and national legislations have been narrated by a number of interviewees, for example CONS 1. O&GI 3, GOV 1 and GOV 2. Such changes in legislations and regulations, whilst add to the complexity of decommissioning business, may add to the cost of decommissioning hence affect the estimates of the provisions.

A number of our interviewees, ACC1 and CONS 2, agree that oil and gas companies must adhere to the legal and regulatory disclosure requirements and provide additional detailed voluntary types of provisions for decommissioning costs disclosures. However, other interviewees, O&GI 2 and O&GI 4, argue that costs of providing such disclosures and fear that sensitive information may leak to competitors are some of the reasons why oil and gas companies may opt not to disclose such information.

7. CONCLUSION

Our analysis reveals that there is a rich body of accounting standards and regulations with regard to accounting for provisions for decommissioning costs. The standards require oil and gas companies to disclose fair amount of information on decommissioning costs and their provisions. Should these requirements be adhered to the International Accounting Standards would have provided a solid basis for harmonising accounting practices among oil and gas companies. However, clearer interpretation of the existing standards on accounting for provisions for decommissioning oil and gas assets must be provided along with the standards. This would help accountants to understand these standards and possibly this will form a suitable base for harmonising accounting practices by oil and gas companies.

Our analysis divulges that oil and gas companies listed in the UK have different level of compliance with the decommissioning related disclosure requirements. Whilst a number of companies seems to comply with the majority of the disclosure requirements other companies seem to be less compliant with these requirements. The SORP disclosure requirements seem to have been well met in most of the cases. On the contrary, disclosure requirements of the IASs seem to have attracted different attention and compliance by different oil and gas companies. Although a number of oil and gas companies seem to be complying with the disclosure requirements of IASs, however the amount of numeric and narrative information provided is minimal. Detailed information related to decommissioning obligations, provisions and expenditure are required. These information is about timing, amount, changes to the decommissioning estimates, underpinning reasons for such changes, timing of cash outflows and discount rate used; a breakdown of the decommissioning obligations into geographical areas and individual fields is a need.

Oil and gas companies listed in the UK see that more information about provisions for decommissioning costs should be disclosed to stakeholders. However, different challenges hold such practice from being exercised. Being oil and gas decommissioning a relatively new business to the UK oil and gas companies, further explanations and interpretations of the AISs is required and possibly best practice examples need to be imported from other countries' experience in this context.

This study has significant policy and practical implications. It highlights the current diverse state of disclosure practices among listed oil and gas companies in the UK therefore necessitates clearer international accounting standards and interpretations of such standards. Our study provides a stepping stone for future studies on this topic and basis for future similar studies. This study, being the first of its kind, faces a number of limitations. One key limitation is the small number of interviews. The number of companies included in the content analysis is limited to those that are listed in the UK and have decommissioning liabilities. However, these limitations are highlights for further research on the same topic that extend s the sample to oil and gas companies listed on a number of international stock markets.

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