IFRS 6 & IAS 16: Accounting for Farm-Outs in the Extractive Industries

Excerpt, IFRS Discussion Group Report on Meeting – September 16, 2010

Those operating in the extractive industries, including oil and gas enterprises, frequently enter into “farm-out” or “risk-sharing” arrangements. A farm-out arrangement involves an enterprise (“the farmor”) agreeing to provide a working interest in an oil and gas property to a third party (“the farmee”), provided that the farmee performs certain work on the property. For example, if the farmee agrees to drill four wells, it would receive a 30 percent interest in the property’s production and would, upon earning its working interest, generally be given joint control over the operation of the property. There are a number of challenges in accounting for these transactions under IFRSs including whether:

(a) IFRS 6 *Exploration for and Evaluation of Mineral Resources* precludes the derecognition of a portion of a property subject to a farm-out arrangement in the exploration and evaluation phase; and

(b) the farmor derecognizes a portion of a producing property subject to a farm-out arrangement with related gain/loss recognition and, if so, at what point in the arrangement.

The issue is whether a request should be made to the IFRS Interpretations Committee for clarification of the accounting treatment of any specific aspects of these arrangements.

The members recommended that the staff consult with other national standard setters to determine how these transactions are being accounted for in other jurisdictions. In addition, members suggested that the staff conduct research to determine whether similar types of risk-sharing arrangements are utilized in other industries and how they are accounted for in those industries. The members also identified a conflict between the guidance in IAS 27 *Consolidated and Separate Financial Statements*, IAS 31 *Interests in Joint Ventures*, and SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*, relating to the formation of a joint venture when a business is contributed by one of the venturers. The members recommended that the conflict be brought to the attention of the IFRS Interpretations Committee.

Source: www.frascanada.ca/ifrs-discussion-group