



DNO Analyst meeting
22 June 2006

DNO ASA Corporate Finance



Agenda

- **Introduction**
- **IFRS 6 – Exploration for and Evaluation of Mineral Resources**
- **Successful efforts method**
- **Working interest – net entitlement method**
 - **Production Sharing Agreements (PSA)**
 - PSA structure
 - Examples
 - **Use of methods**
 - Deferred tax
 - Differences in net profit and production
 - Examples
- **Norwegian tax**
 - Amendments to the Petroleum Tax Act in 2005
 - Income tax expense DNO



IFRS 6 Exploration for and Evaluation of Mineral Resources

- Developed as no IFRS standard addressed the accounting for extracting industries, and those activities are excluded from IAS 38 Intangible Assets and IAS 16 Property, Plant and Equipment
- First step towards a comprehensive IFRS on extractive industries;
 - **covers only the exploration phase, not beyond**
 - **permits entities to continue use accounting policies applied before adopting the standard**
 - **requires entities to perform an impairment test on those assets when facts and circumstances suggest that carrying amount may not be recoverable**
- Standard leaves areas of industry practice unaddressed, e.g PSAs, farm-ins/outs, asset swaps (currently covered in SORP (UK) and US GAAP)
- Effective date is 1 January 2006
- No major implications for companies using successful efforts method;
 - **already performing impairment testing**
- New revised standard not expected until 2008-2009 at the earliest
 - **Exposure draft expected in 2007**
 - **Not expected to solve unaddressed areas mentioned above**



Successful efforts method

- Developed under USGAAP, the dominating method among Norwegian oil companies to account for exploration costs
- All exploration costs with the exception of acquisition costs of licences and drilling costs of exploration wells, are charged to expense as incurred
- Drilling costs of exploration wells are temporarily capitalised pending the evaluation of potential oil and gas reserves
- **Commercially recoverable:** costs are capitalised together with development costs related to the field
- **Dry well/not commercially recoverable:** costs are expensed (*exception:* dry well can remain capitalised if part of a field under development/ production)

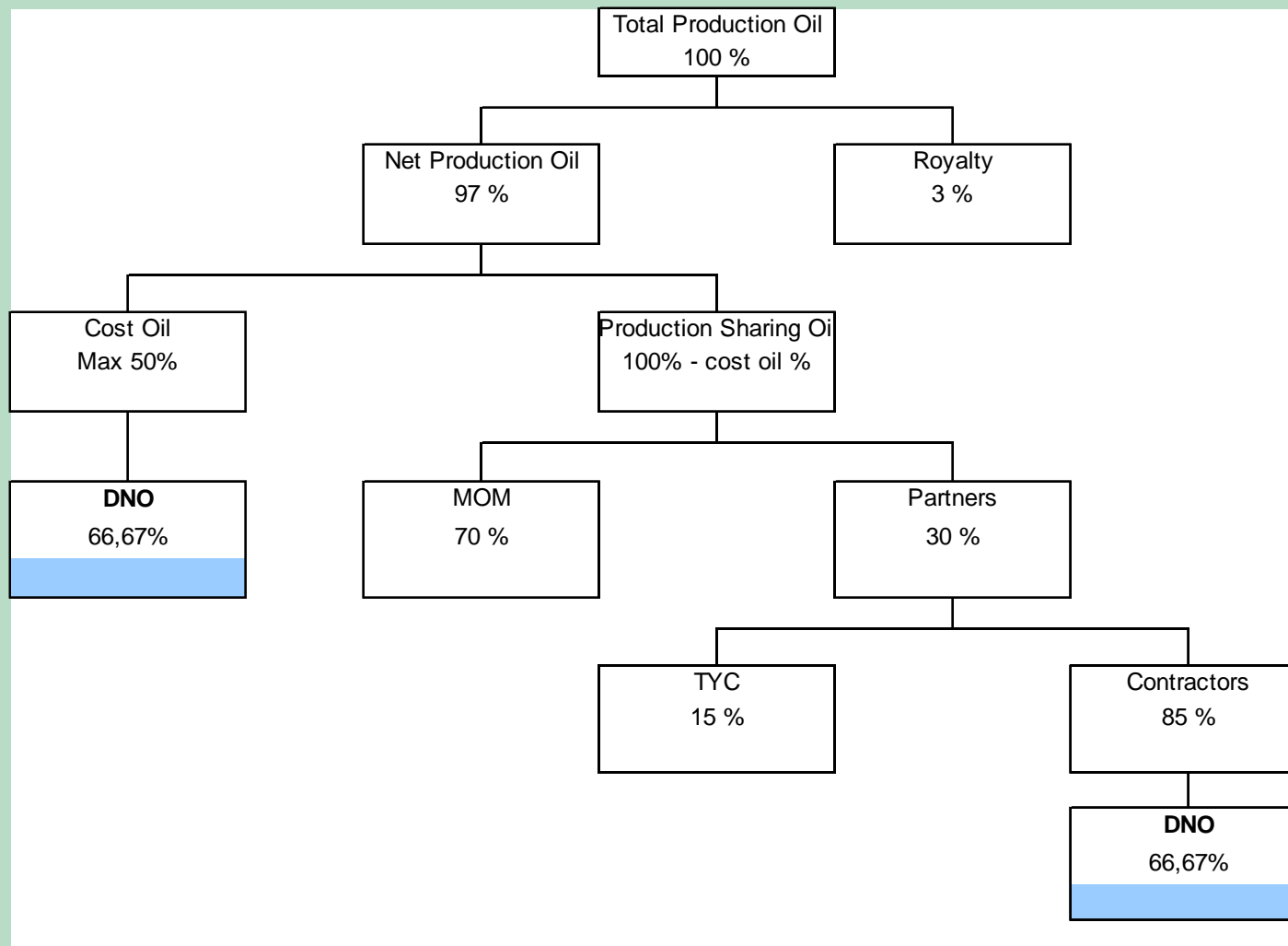


Production Sharing Agreement (PSA)

- **Regulates how the production is to be shared between the contractors and the ministry**
- **Royalty**
 - A fixed percentage of the gross production
- **Cost oil**
 - All recoverable cost is allocated to the cost oil
 - Cost oil shared among the paying partners
 - Cost recovery
- **Production Sharing Oil – Profit oil**
 - Profit oil is shared between the ministry and the partners
 - $\text{Production} - \text{Royalty} - \text{Cost oil} = \text{Profit oil}$
 - Government take share of oil going to MoM & TYC
- **Portion of non recoverable cost may vary**



PSA - Block 43 in Yemen





Working interest and net entitlement method

- **Under NGAAP, DNO presented its activities under PSAs using the working interest method;**
 - Working interest of total oil produced (net of royalty) presented as revenue, and the corresponding government take presented as income tax expense
- **Lack of guidance in IFRS, hierarchy in IAS 8.10-12 followed;**
 - => US GAAP practice – net entitlement method
 - Only working interest of oil produced, after deduction of government take, is presented as revenue
 - The part of the government take assigned to cover DNO's corporate tax, is not deducted from revenue, as this part meets the definition of tax in IAS 12 Income Taxes
- **Net entitlement is for the mandatory financial statements only, working interest will be used in the MD&A, operational reviews (RoO) and analyst presentations**
 - Working interest provides a more complete view of the economic flows in total production under a PSA
 - Working interest provides better comparability between different fiscal regimes
 - Change of method does not impact DNO's strategy, management of these activities or cash flow generation



Example – Production sharing

DNO share of total production			
BL 43			
		Contractors	DNO share
Production		100	
- Royalty (MOM)	3 %	3	
Production for "distribution"		97	
Cost oil to contractors	50,00 %	48,50	32,33
Profit oil	50,00 %	48,50	
- MOM on profit oil	70 %	33,95	
Profit oil to partners		14,55	
- TYC	15 %	2,18	
Profit oil to contractors		12,37	8,24
Total oil to partners/DNO		60,87	40,58



Example – Working interest vs net entitlement

- Assumptions:
 - No deferred tax
 - Cost oil 50%
 - All cost recovered within the year
 - Company tax 35%
- Different treatment of tax (Government take)
- Equal profit

Working Interest

Profit oil + cost oil	40,58
+ Government take	24,09
Income	64,67
- Cost oil	32,33
P/L b tax	32,33
- Tax (Governm. Take)	24,09
Profit	8,24

Net Entitlement

Profit oil + cost oil	40,58
+ Company Tax	4,44
Income	45,02
- Cost (cost oil)	32,33
P/L b tax	12,68
- Company Tax	4,44
Profit	8,24



Working interest and net entitlement method

- **Deferred tax**
 - IAS 12 Income taxes requires that entities account for the tax consequences of transactions in the same way as they account for the transactions themselves
 - Deferred tax assets and liabilities are thereby calculated on tax bases both on field level (cost oil) and on company level
- **The two methods result in different net profit and production**
 - Different tax rates on tax positions
 - Differences between working interest production and net entitlement production are due to government part of oil produced
 - Government take of produced oil is *not* included in net entitlement production
 - Higher revenues in first quarter as a result of carry forward of cost oil position from previous quarters



Example with deferred tax, assumptions

Year 1:	Field in development
Year 2-4:	Production
Royalty:	3%
Max cost oil:	50%
Government take:	74,5%
Corporate tax:	35%
DNO, share:	66,7%



Assumptions, continued

			Year 2	Year 3	Year 4	Total
Production 100%	A		1 000 000	9 000 000	5 000 000	15 000 000
Royalty	B	= A x 3%	(30 000)	(270 000)	(150 000)	(450 000)
Production after royalty	C	= A-B	970 000	8 730 000	4 850 000	14 550 000
DNO Share production after royalty	D	= C x 66,67%	646 667	5 820 000	3 233 333	9 700 000
DNO Share, max cost oil	E	= D x 50%	323 333	2 910 000	1 616 667	4 850 000
DNO Share, actual cost oil	F	see calculation	323 333	1 743 590	764 444	2 831 368
DNO Share, profit oil	G	= D-F	323 333	4 076 410	2 468 889	6 868 632
DNO share, Government take, profit oil	H	= G x 74,5%	240 883	3 036 926	1 839 322	5 117 131
DNO Share profit oil, cash	I	= G-H	82 450	1 039 485	629 567	1 751 501
Corporate tax, 35%	J	= I/65% x 35%	44 396	559 722	338 997	943 116
Production working interest	D	= D	646 667	5 820 000	3 233 333	9 700 000
Production Net Entitlement	K	= F+I+J	450 179	3 342 797	1 733 009	5 525 985
Oil price/bbl			60	65	60	



Working interest (WI)

Profit & loss (mill USD)	Year 1	Year 2	Year 3	Year 4	Total
Oil sales	-	38,8	378,3	194,0	611,1
Opex, recoverable	1,0	5,2	46,6	25,9	78,6
DD&A	-	6,7	60,0	33,3	100,0
Result before tax	(1,0)	27,0	271,7	134,8	432,5
Tax, payable	-	14,5	197,4	110,4	322,2
Tax, deferred	(0,7)	5,6	5,0	(9,9)	0,0
Total taxes	(0,7)	20,1	202,4	100,4	322,2
Result after tax	(0,3)	6,9	69,3	34,4	110,3
Cashflow	(11,0)	(30,8)	94,3	57,8	110,3
Effective tax rate	74,5 %	74,5 %	74,5 %	74,5 %	74,5 %
Capex, mill USD	10	50	40	-	100
Production, mill bbl (WI)	-	0,65	5,82	3,23	9,70
Opex/bbl	-	8,0	8,0	8,0	8,1
DDA/bbl	-	10,3	10,3	10,3	10,3
(Def tax asset)/def tax (Bal)	(0,7)	4,9	9,9	-	0,0



Net entitlement (NE)

Profit & loss (mill USD)	Year 1	Year 2	Year 3	Year 4	Total
Oil sales	-	27,0	217,3	104,0	348,3
Opex, recoverable	1,0	5,2	46,6	25,9	78,6
DD&A	-	6,7	60,0	33,3	100,0
Result before tax	(1,0)	15,2	110,7	44,8	169,7
Tax, payable	-	2,7	36,4	20,3	59,4
Tax, deferred	(0,4)	2,6	2,4	(4,7)	(0,0)
Total taxes	(0,4)	5,3	38,8	15,7	59,4
Result after tax	(0,7)	9,9	72,0	29,1	110,3
Cashflow	(11,0)	(30,8)	94,3	57,8	110,3
Effective tax rate	35,0 %	35,0 %	35,0 %	35,0 %	35,0 %
Capex, mill USD	10	50	40	-	90
Production, mill bbl (NE)	-	0,45	3,34	1,73	5,53
Opex/bbl	-	11,5	13,9	14,9	14,2
DDA/bbl	-	14,8	17,9	19,2	18,1
(Def tax asset)/def tax (Bal)	(0,4)	2,3	4,7	-	(0,0)



Capex - Recoverable cost

Capex/Recoverable cost (mill USD)	Year 1	Year 2	Year 3	Year 4
Capex, DNO share	10,0	50,0	40,0	-
Recoverable cost				
Recoverable cost, OB	-	11,0	46,8	20,0
Opex, DNO share	1,0	5,2	46,6	25,9
50% capex, DNO share	5,0	25,0	20,0	-
= Total recoverable cost	6,0	41,2	113,3	45,9
- used	-	19,4	113,3	45,9
+ 50% capex DNO share	5,0	25,0	20,0	-
= Recoverable cost CB	11,0	46,8	20,0	-
Oilprice/bbl	-	60,0	65,0	60,0
Total recoverable cost, bbl	-	686 222	1 743 590	764 444
Max cost oil, DNO share, bbl		323 333	2 910 000	1 616 667



Deferred taxes

Deferred tax (mill USD)	Year 1	Year 2	Year 3	Year 4
PP&E, Book value OB	-	10,0	53,3	33,3
Capex	10,0	50,0	40,0	-
- DD&A	-	(6,7)	(60,0)	(33,3)
PP&E, Book value CB	10,0	53,3	33,3	-
Recoverable cost CB	11,0	46,8	20,0	-
Difference	(1,0)	6,6	13,3	-
Deferred tax 74,5% (working interest)	0,7	(4,9)	(9,9)	-
Deferred tax 35% (net entitlement)	0,4	(2,3)	(4,7)	-



Amendments to the Petroleum Tax Act

- **Early in 2005, amendments to the Petroleum Tax Act was introduced**
 - *Objective:* create neutrality between participants in exploration activities related to tax position
 - Oil companies that are not in a tax position, can apply for a cash refund from the state of the tax value (78%) of exploration costs incurred in 2005 or later
 - Limited up to the yearly taxable loss
 - No capitalisation of exploration costs is demanded, and will therefore continuously be deducted
 - Exploration costs comprise all costs for exploration for petroleum resources, including both direct and indirect expenses
- **For DNO, this results in a receivable on the state for repayment of exploration costs for 2005**
 - Positive taxes payable (tax income) in the P&L in periods with exploration activity
 - The calculation of the receivable is made on a quarterly basis



Income tax expense DNO

Explanation of Note 8 Taxes - First quarter 2006

Note 8 Taxes

Income tax expense

Taxes payable	45,3
Deferred taxes	-26,5
<u>Income taxes payable related to PSAs</u>	<u>-46,6</u>
<u>Total income taxes</u>	<u>-27,8</u>

- The taxes payable is 78% of exploration costs (Norway) in the quarter, which is refundable from the state
- Deferred taxes are calculated both on field level (cost oil) and on company level
- PSA taxes payable is the 35% corporate tax in Yemen