



# Petroleum Accountants Society of Canada

## 2007 ACCOUNTING PROCEDURE (October 2007 Final Draft)

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This material has been prepared for the use of those who have previously attended a workshop or presentation on the material.

Other users should exercise caution when interpreting the material contained herein.

Any questions as to the content of this material or the 2007 PASC Accounting Procedure (draft) may be directed to PASC.

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# The Contributors

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18 Commenting Companies  
(2005 Draft)

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# Session Objectives

- Provide an understanding of the need for a new Accounting Procedure
- Provide a greater comfort and understanding of the 2007 draft
- Gather feedback, comments and questions of clarification to further enhance the document

# Session Approach

- Set the foundation
- Provide an overview of the structure
- Customizing the Accounting Procedure
  - Rates & Elections
    - Factors that may influence the various rates & elections
  - Modifications to the Accounting Procedure
    - Highlight the significant clause changes
    - Highlight what was chargeable in 1996 but not in 2007
    - Other notable changes from the 1996 version

# The Need

- 11 years since the last version and the environment has changed
- Increased need to formally document accepted joint venture accounting practices
- Increased need for transactional justification and support
- Alignment with new industry model agreements (e.g. 2007 CAPL Operating Procedure)

# The Need

- Increase in audit claims and disputes
  - Outsourced activities
  - Cost allocations
  - Handling of ICPs
  - Chargeability criteria unclear
  - Liberal interpretation
  - Variations in practice
  - Unclear approval processes

# The Need

- Weak or lack of prescribed methods
  - Adjustments
  - Payout accounting
  - Cash calls & operating advances
  - Unclear approval mechanisms
- Existing contracts do not reflect current practice
  - Short payments
  - Different audit periods

# The Need

- Risk of limiting chargeable costs
  - Broader scope
  - On-site definition not relevant
- Risk of over-recovering overhead
  - Direct charge items without adjustment to overhead
- Risk of under-recovering overhead
  - Contract well operating service charges
  - Effects of inflation & increasing costs of operations

# The Impact

It takes a steadily increasing amount of effort and cost to negotiate, manage, administer and account for joint venture activities under differing versions of Accounting Procedures

# Key Objectives for the Update Project

- Simplification through clarity
- Completeness
- Guidance

# 2007 Accounting Procedure

- Structure of:
  - Annotated Version (Draft Bulletin)
  - Contract Version
  - 2007 Accounting Procedure Articles

# Understanding the Key Changes

To understand what has changed we must first understand what has not changed from the 1996 version



# 1996 to 2007 Version

- Underlying principles of 1996 version brought forward
- Types of direct charges
- Direct charge criteria in general
- Overhead elections
- Material & inventory management
- Ability to customize the Procedure

# Article I

- Definitions added, changed, moved or deleted
- Joint venture accounting principles and guidance added

# Article II

- Major re-write of all clauses
- Modification to the Procedure will be necessary for some costs to be chargeable

# Article III

- Major rewrite of all clauses
- Modification to the Procedure will be necessary to include the Overhead escalation provision

# Articles IV & V

- Major rewrite for clarity

# Application of the Accounting Procedure

## ■ Joint Operations

- Linked directly to operations contemplated by head agreement and operating procedure

2007 CAPL Operating Procedure provides for project approval mechanism but expressly defers to the Accounting Procedure for the chargeability of specific cost elements

# Definitions

## No Change

- Agreement
- Controllable Material
- Joint Account
- Joint Property
- Non-Operator
- Production Engineering
- Technical Services

## Deleted

- Alliance
- Initial Construction
- Professional Consulting Services
- Warehouse

## Replaced

- Administrative Services with Administration
- Production Office with Field Office

# Definitions

## Moved to Article III

- Completion
- Construction Project
- Drilling
- Equipping
- Exploration

## Moved to Article IV

- New Price

## Moved to Appendix I

(as optional)

- Affiliate
- Second Level  
Supervision

# Definitions

## Revised

- Joint Operations
- Material
- On-Site
- Operations and Maintenance
- Operator
- Party
- Supervision

## Added

- Chart of Accounts
- Incentive Compensation Programs
- Overhead



# Rates & Elections

## Clause 104 Cash Calls

- Factors to consider:
  - Optional threshold for capital cash calls
  - Mechanics defined in detail
  - Directs Operator on how to administer for A&D activity
  - Non-Operator can net advances if Operator fails to administer advances appropriately

# Rates & Elections

## Clause 110

### Approvals & Amendments

- Factors to consider:
  - Defined process for approving specific items
  - Requirements for disclosure
  - Separate process for amendments to the Accounting Procedure
  - Subordinate to governing agreements

# Rates & Elections

## Clause 111

### Authority for Expenditures

- Factors to consider:
  - AFE or decision record (mail ballot)
  - Spend limits
  - Minimum AFE content
  - Role of Supplemental AFE
  - Administering scope changes
  - Remedies for Non-Operator

# Rates & Elections

## Clause 202 Employee Benefits

- Factors to consider:
  - Related clauses (101.f, 201.a,e-g & 202.b)
  - Prior year's actual cost
  - Specific exclusions
  - Special treatment for ICPs

# Rates & Elections

## Clauses 302 & 303 Overhead

### ■ Capital

- Abandonment & Reclamation
- Catastrophe
- Completions
- Construction
- Drilling
- Equipping
- Exploration

### ■ Operations & Maintenance

- Operating Overhead Rate Base
- Producing Well

# Operating Overhead Rate Base

- Cost of Operations & Maintenance
- Excluding
  - Subsurface rights
  - Litigation and claims
  - Abandonment and reclamation
  - Salvage credits
  - Third party fee income
  - Taxes and assessments
  - Items that attract lower overhead
  - Other exclusions as approved

# Overhead Options

## ■ Capital

- Flat 2%
- Traditional Sliding Scale by type of undertaking
- As published by PASC

## ■ Operations & Maintenance

- Producing Well Rate
- Fixed amount per month
- % of Operating Overhead Rate Base
- Lower % for high dollar cost items

Escalation Factor Removed

# Overhead Election Alternate A

- 2% on all capital undertakings
- 10% on Operating Overhead Rate Base
- 2% on
  - Property Tax
  - Processing charges
  - Utilities/Electricity
  - Environmental/ecological fees or levies
  - Other exclusions as negotiated and approved

Starting point for Overhead negotiations  
Can be changed using the Modifications Page

# Overhead Elections Alternate B

## Capital

For each type of capital undertaking

- 2% or
- Sliding Scale
  - 5% on first \$250,000
  - 3% on next \$250,000
  - 1% on the remainder
- As published by PASC

## Operations & Maintenance

\_\_\_ \$150/month Producing Well Overhead

\_\_\_ \$\_\_\_ per month

\_\_\_ 10% of Operating Overhead Rate Base  
Wells & Facilities

\_\_\_ 10% of Operating Overhead Rate Base  
Facilities Only

\_\_\_ 2% on

- Property tax
- Processing charges
- Utilities/Electricity
- Ecological/environmental fees or levies
- Others as negotiated and approved

Starting point for Overhead negotiations  
Can be changed using the Modifications Page



# Customizing the Document Modifications

- In general
  - Your company's "must haves" & "do not want"
  - Know your "deal breakers"
  - Capture the rationale
- Be aware of the impact



# Understanding the Impact of Key Changes

- Application of the Accounting Procedure
- Approvals & disclosure requirements
- Special accounting matters
- Remedies to Non-Operators
- Audit timeframes, cost sharing & adjustments

# Understanding the Impact of Key Changes

## ■ Chargeable items

- labour
- Incentive Compensation Programs & limitations
- ecological & environmental
- abandonment & reclamation

## ■ Treatment of specific charges

- Operator's Affiliates
- in-house & outsourced engineering & related administrative costs
- third party fees (processing, operating)

# Accounts Receivable Management

- Sets minimum level of information for all aspects of accounting including payout accounting
- Formalizes current practice for short paying specific items
- Operator's response time for inquiries increased to 30 days
- Mechanics for prior period production, revenue and operating expense adjustments
- Permitted adjustments beyond 26 month timeframe of "deemed correct" provision

# Audit Process

- Timeframes for closure within limitation periods
- Reduced number of extensions
- Defined dispute resolution process
- Cost sharing & proceeds from adjustments

# Accounting Activities Performed by the Operator

- Accounting for Joint Operations
  - Operator's accounting responsibilities
  - Administration of GST
  - Expanded application of traditional allocation provisions
  - Approval of costs & associated Overhead implications

# Application to Operator's Affiliates

- Definition of Operator modified
  - includes its Affiliates for joint venture accounting purposes
    - Affects chargeability of non-arm's length transactions
    - Extends cost ceilings & limitations
    - Removes Operator's ability to profit from sub-contracting to an Affiliate

# Types of Labour

PASC 1996	PASC 2007
<p>Technical Services</p> <ul style="list-style-type: none"><li>- Providing specific engineering, geological and other professional services</li></ul>	No Change
<p>Supervision</p> <ul style="list-style-type: none"><li>- The supervision of employees and/or contract labour directly employed On-site in the conduct of Joint Operations</li><li>- Not restricted to level</li></ul>	<p>Supervision</p> <ul style="list-style-type: none"><li>- Employees in the conduct of Joint Operations who provide direct <u>first level</u> oversight of Operator's employees and/or contract labour</li></ul>

# Labour Related Definitions

	PASC 1996	PASC 2007
Production Engineering	<p>FACILITIES AND OPERATIONS ENGINEERING</p> <ul style="list-style-type: none"> <li>- Support of Operations &amp; Maintenance</li> <li>- Defined specific list of activities</li> <li>- Irrespective of the location of the person doing the work</li> </ul>	No change
Admin Services	<p>SUPPORT SERVICES</p> <ul style="list-style-type: none"> <li>- Accounting, purchasing, clerical, secretarial, whether On-Site or not</li> </ul>	<p>Changed to Administration</p> <ul style="list-style-type: none"> <li>- Activities performed by Operator's employees</li> </ul>
On-Site	<ul style="list-style-type: none"> <li>- AREA of routine operations.</li> <li>- PRODUCTION OFFICE where field employees are based</li> </ul>	<ul style="list-style-type: none"> <li>- Area reference retained</li> <li>- "Field Office"</li> <li>- Other Control Locations</li> </ul>
Production Office	<p>THE OFFICE</p> <ul style="list-style-type: none"> <li>- Where field employees and supervisors, who are chargeable under 201(a)(1), report to work on a daily basis</li> <li>- Where the wells &amp; facilities are managed, supervised and controlled</li> <li>- "Primary" function of this office is the routine operations of the wells/fields/facilities</li> </ul>	<p>Changed to "Field Office"</p> <ul style="list-style-type: none"> <li>- Directly serves the daily operations</li> <li>- Serves as a staging area for field staff</li> </ul>

# Labour Categories

	Directly Chargeable Approved Capital Projects or Ongoing Operations	Chargeable with Approval Approved Capital Projects or Ongoing Operations
<b>On-Site</b>	<ul style="list-style-type: none"> <li>✓Field Operations (E&amp;C)</li> <li>✓First Level Supervision (E)</li> <li>✓Production (Operations &amp; Facility) Engineering (E&amp;C)</li> <li>✓Technical Services (E&amp;C)</li> <li>✓Labour for Capital Projects (E&amp;C)</li> <li>✓Other Engineering (E&amp;C)</li> </ul>	
<b>Off-Site</b>	<ul style="list-style-type: none"> <li>✓Field Operations (E)</li> <li>✓Production (Operations &amp; Facility) Engineering (E&amp;C)</li> <li>✓Technical Services (E)</li> <li>✓Labour for Capital Projects (E)</li> <li>✓Other Engineering (E&amp;C)</li> </ul>	<ul style="list-style-type: none"> <li>✓First Level Supervision (E)</li> <li>✓Technical Services (C)</li> </ul>

E = Employee    C = Contracted/Outsourced



# Labour Costs

- Quantified
  - Time sheet
  - Equitable allocation of time
  
- Valued at
  - Actual cost
  - Per diem rate (hourly or daily) rate based upon actual cost with specified components
  - Additional options for capital projects
    - Percentage of project cost
    - Fixed amount per AFE estimate
    - Disclosure requirements
  - May include Incentive Compensation Program payments

# Incentive Compensation Programs

- Defined as variable portion of salaries & wages
- Stated criteria to qualify
  - Documented program available to all employees
  - Influences chargeability under labour clause
- Limitations in labour clause (Clause 201.e)
  - Cash outlay in 12-month period of being awarded
  - Allocated using same basis as base salary costs
  - Ceiling of 50% of base earnings excluding ICP
  - Excludes costs or value attributable to stock options

# Engineering for Capital Projects

- Requirement for project approval under approvals clause
- Actual cost based upon:
  - time sheet
  - as invoiced

## In-house Engineering

- Day rate/per diem rate
- Percentage of total project costs excluding Overhead
- Requirement to disclose as a line item

## Outsourced/Contracted Engineering

- Percentage of total project costs excluding Overhead
- Requirement to disclose as a line item
- Costs as specified in the contract for service or work order
- Restricted to engineering project team costs & support services
- Includes service provider's administrative costs



# Administrative Costs

- Definition of "Administration"
  - Replaces "Administrative Services" from 1996 PASC
    - Cost of Operator's administrative activities only
    - Recovered via overhead
- Treatment of:
  - Costs of Operator's outsourced Administration
  - Costs of service providers' & suppliers' administrative activities

# Third Party Services

- As may be required for Joint Operations
- Expressly includes
  - Gathering, handling and processing charges
  - Contract well/facility operations/reporting
- Expressly prohibits costs of sub-contracting Administration or Overhead related activities

# Equipment and Facilities

- Used in the conduct of Joint Operations
- Owned or leased
  - Provided by the Operator (or its Affiliate)
    - Criteria & restrictions
  - Jointly owned
    - Allowable costs including handling of leases

# Communication & Computerized Support

- Communication devices
  - Approval requirements
  - Costs of operating and maintaining stem from approval
- Computerized support
  - As required to monitor Joint Operations
  - Valuation methods

# Ecological & Environmental Costs

- Traditional criteria retained
- Types of costs
  - Direct costs
  - Government fees and levies
  - Includes greenhouse gas levies

# Abandonment & Reclamation

- Statutory or contractual requirements
- Application
- Chargeable except as otherwise approved
- Separate Overhead election in Article III for previously producing wells & facilities

# Customizing the Procedure

## ■ Article I

- Definitions that need to be modified
- Provisions you can't live with

## ■ Article II

- Start with "The Grid" (Appendix III)
- Specific costs that should or should not be directly chargeable
  - Consider
    - With or without approval
    - Any other chargeability criteria
- Review other default rates

# Other Default Rates

Clause 103.a	Interest rate
Clause 105.a	Operating Fund
Clause 201.e	ICP limitation
Clause 205.b	Warehouse handling fee
Clause 302 & 303	Overhead Rates \$ Thresholds

# Customizing the Procedure

## ■ Article III

- Definitions that need to be modified
- Check items subject to 2% overhead rate (i.e. inclusions in clause 302.a.ii (Alternative A) and 303.h.4 (Alternate B))
- Note definition of "Operating Overhead Rate Base" automatically changes with the above

## ■ Articles IV & V

- Review the clauses to confirm the provisions are acceptable and workable

# Customizing the Document Reminder

- In general
  - Your company's "must haves" & "do not want"
  - Know your "deal breakers"
  - Capture the rationale
- Be aware of the impact

# Why Do It Now?

## ■ Primary benefits

- Identifies issues not addressed
- Ensures wording is clear
- Develops in-house understanding
- Creates state of readiness
- Provides guidance to negotiators when adopted
- Capturing rationale helps others more readily accept modifications

# Why Do It Now?

## ■ Secondary benefits

### - Influence the published version

- Issues not addressed
- Unclear wording
- Accurately capture current & go-forward industry practice
- Industry accepted document that considers your company's position

# Why Do It Now?

## ■ Realizing the value

### - Industry alignment

- Common wording, principles & practices

### - Time, effort and cost savings

- Industry accepted document that considers your company's position

vs

- Negotiating your company's modifications on an individual contract by contract basis

# Commenting Options

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- Create your company's Rates, Elections & Modifications Page and share what you're changing and the rationale
- Comment Template
  - Focus: Key issues and major problem areas
    - State the problem or concern
    - Propose a solution
- Paper, E-mail or Upload to PASC website
- Company Presentations
- PASC Website Q&A Forum

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