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These Procedures set out what is generally regarded in the Industry as good practice. They are not mandatory and operators may adopt different standards in a particular situation where to do so would maintain an equivalent level of reporting.

Contents **Page**

1 Management Summary

This is the report of the workgroup sponsored by the Oil Industry Finance Association and the Finance Directors Forum to reduce and standardise across the Industry the work surrounding Well Reviews. The purpose of this document is to lay out a set of "Minimum Standards" as to when Well Reviews would be required to be completed and then provide a broad framework for carrying out these Well Reviews as a means of standardising and streamlining effort. The workgroup concluded that a number of unnecessary well reviews were being done in instances where:

- the partnerships were not changing (i.e. continuous appraisal/development/production drilling operations);
- where actual costs were not materially different from the 'Estimated Final Costs' (EFC) prepared during/after completion of the drilling operations;
- where changes in the drilling contract strategy in the industry in recent years have changed the emphasis in this area.

However it was considered unreasonable to be too prescriptive as to how Well Reviews should be completed and it was felt prudent that we should only stress the minimum requirements. Thereafter companies/ventures can decide what additional requirements they practically need.

The recommendations centre on:

i that well reviews are **not** required for continuous appraisal/development/production drilling operations on the same licence with the same JV partner equities unless dictated by:

   - contractor incentivisation;
   - first/last well in that drilling scheme;
   - internal management requirement;
   - JV partners requirement.

   All other drilling operations will require a Well Review to be completed within six months of the completion of the drilling operation.

ii defining tolerance limits as to when Well Reviews are necessary i.e. a full review will take place, where 'actual costs' differ from the EFC by >15% (or £10,000, whichever is the lower) on an individual account code.

iii defining the type of Well Review required for differing types of well costs (i.e. detailed physical reconciliations for Tangible/Bulks costs whereas a more analytical approach to Rig Costs, Services, Overheads, Logistics).

iv recommending the final well EFC is completed within one month of completion of the well activity.

v defining the maximum timeframe for the completion of a Well Review (maximum of 6 months after completion of the well activity), and, subsequent closure of the AFE (maximum of 12 months after completion of the well activity).

These practices will achieve savings in the overall effort required to maintain fit for purpose well accounting records which respect internal management, joint venture management and external needs. The subsequent savings can then be invested in adding value to the business. However these changes can only be implemented if supported by joint venture management and subsequent joint venture audit.

As part of a subsequent review, detailed procedures have been developed for the more contentious well accounting issues (e.g. rig mobilisation and demobilisation, rig modifications, bits re-usage etc). These are covered in detail in Section 4.

2 Introduction

The Finance Directors Forum (FDF) of UK Operators (in association with OIFA) has sponsored a series of initiatives to undertake a business process review within the accounting functions of the UK upstream oil and gas industry. As part of the initial tranche of areas tackled, focus was placed on Well Reconciliation procedures. The perceived problems in this area of accounting which were shared by a majority of companies were:

- they are seen as a time consuming, labour intensive area of work which in a majority of instances failed to highlight significant errors/problems;
- there is seen to be dubiety as to whom the target audience is (principal audience is JV auditors, accountants, drillers);
- timing problems as to when work was completed;
- no consideration of main exposure areas, or to what extent value was being added by completing the process;
- no similar exercise completed for significant platform maintenance/inspection or platform capex activities;
- little consideration given to the type of drilling involved (i.e. platform drilling versus shared mobile rig drilling);
- the whole well accounting industry has moved on considerably in the last few years – the contracting strategies mean a lot more of the primary accounting is done by the contractors rather than Operators.

Therefore it was considered an area of significant effort which required some analysis to clarify/simplify:

- the purpose of the process;
- its continued relevance in all drilling operations;
- the timing as to when Well Reviews should be effectively completed.

The terms of reference which the group agreed were to set 'Minimum Standards' for types of well operations when Well Reviews are required rather than exhaustive prescriptive procedures of how they should be completed. It was however felt to be an area of accounting which required a stepped approach at moving it to a greater degree of uniformity. As part of a subsequent review it was felt that detailed procedures could be developed for the more contentious well accounting issues (e.g. rig mobilisation and demobilisation, rig modifications, bits re-usage etc).

It was also consciously decided to change away from the word 'Reconciliation' to the word 'Review' to foster the emphasis away from detailed accounting work and permit a higher level analytical review type approach where applicable.

3 Well Review

3.1 Purpose

The Well Review is an internal management control process which uses a combination of detailed accounting reconciliation and analytical review techniques (where applicable) in the verification of well costs which materially differ from the end of well EFC (i.e. >15% per account code). This process will provide well cost data for benchmarking purposes and for future well cost estimating purposes.

3.2 Proposals

i The group recommend that well reviews are **not** required for continuous appraisal/development/production drilling operations on the same licence with the same JV partner equities unless dictated by:

- contractor incentivisation (i.e. the drilling alliance contract is incentivised on a well by well cost basis);
- it is the first/last well in that drilling scheme;
- it is an internal management requirement;
- it is a JV partner requirement.

All other drilling operations will require a Well Review to be completed within six months of the completion of the well activity.

ii When a Well Review is required:

- A full well review will take place, where 'actual costs' differ from the EFC by >15% (or £10,000, whichever is the lower) on an individual account code basis.

The review process recommended is:

- Tangible/Bulks to be physically reconciled to technical documentation available (e.g. casing records, bit records, mud reports). To minimise the work involved it is recommended that each account code should be reconciled to within a tolerance of 5% (or £5,000 whichever is the lower).

  NB: It is recommended where applicable that the mud companies should do the mud reconciliations.

- All other cost categories (e.g. Rig Costs, Services, Overheads, Logistics) subject to a technical review by drilling engineers to justify variances of >15% from EFC;

- Excepting Overheads and Logistics, subject to review by multi-venture audit and certification.

iii Other Points:

- single well operations should particularly focus on “on/offhire stocks”, “mob/demob costs”, “cut-off dates” to ensure the correct costs have been charged;

- first and last wells of a programme should be reviewed placing emphasis on “on/offhire stocks”, “mob/demob costs”, “cut-off dates”.

- respect the tax arrangements and treatments applicable;

- final EFC’s to be completed within one month of completion of the well activity;

- AFEs to be closed within twelve months of completion of well activity.

iv The group also agreed ‘minimum cost categories’ for industry use in accounting for wells:

- Tangibles (e.g. wellhead equipment, casing and tubing, completion equipment);
- Bulks (e.g. bits and coreheads, muds and cements, mud chemicals, additives);
- Rig Costs (e.g. rig rate, mod/demob, survey costs);
- Services;
- Evaluation/Logging Costs;
- Overheads;
- Logistics;
- 100% Costs.

4 Recommended Accounting Policies for Wells

4.1 Rig Mobilisation

Definition: Costs incurred to initiate a drilling rig prior to commencement of a drilling programme. These costs relate to such charges as rig hire, anchor handling boats, towing vessels, aircraft, personnel and administrative costs and include any costs incurred as a result of a delay in rig delivery (for example, waiting on weather).

Policy: For a single well location, mobilisation costs shall be charged directly to the well the rig has been mobilised for.

For multiple well programmes, costs incurred within a seventy two (72) hour period prior to completion of anchoring operations (‘Anchors set’) on the first well shall be attributable to the first well drilled. Costs incurred beyond the aforementioned 72 hour period shall be spread over all wells in the programme up to a maximum of one year; such spread to be based on rig days.

The 72 hour period is based on the reasonable towing time from rig base (for example Cromarty Firth) to another UK North Sea or Atlantic Margin or West of Shetland location. If practice determines this average regular tow time period to be shorter e.g. 48 hours then that figure may be adopted provided the policy is applied consistently.

An alternative specific mobilisation period may be adopted if agreed, in advance, with partners.

In circumstances where the mobilisation time limit is exceeded but only by a marginal amount which results in a non-material adjustment being spread forward over 12 months, the charge may be allocated as if the time limit had not been so exceeded.

4.2 Rig Demobilisation

Definition: Costs incurred to satisfy contractual and customary obligations for the relinquishment of the drilling rig following tight tow from the final well in the rig programme.

Policy: For a single well location, demobilisation costs will be charged directly to the well the rig has been demobilised from.

For multiple well programmes, demobilisation costs will be spread back over the wells drilled in the programme or over the previous 12 months whichever is shorter, on the basis of rig days.

4.3 Rig Certification

Definition: Costs incurred in assessing and certifying the drilling rig as fit for purpose, and meeting all HSE requirements.

Policy: In circumstances where the rig owner has failed to incorporate the costs of certification and inspection in the rig day rate, the cost will be charged directly to a single well location or for a programme of wells the cost will be spread forward to all wells drilled in the programme up to a maximum of 12 months.

4.4 Rig Moves

Definition: Movement of the drilling rig from one well location to another.

Policy: Rig hire costs for the transferee location will commence when the last anchor has been racked and the rig is under tight tow from the transferor location. Boats and helicopter charges follow the same cut off principle.

Rig fuel, lubes, drilling materials and other consumables together with equipment hire will also follow the same cut off principle in that they should be measured at the same time rig hire transfers to the next location and the rig hand-over statement prepared. In circumstances however when inventory specifically required for the transferor well remains on the rig prior to being returned all costs associated with that inventory will be borne by the transferor well, notwithstanding the fact the rig will have been transferred. In circumstances where the transferee location requires a specific piece of equipment unique to the particular well, the transferee location bears the total cost of the equipment, notwithstanding the fact it may have been loaded on the rig prior to transfer.

Materials may be bought for a particular well, not used and transferred to the next well provided that well accepts it and thereby has a probable use for it, in which case the cost will transfer to the second well. If such transfer occurs at the conclusion of a well programme the final well shall bear the cost and corresponding credit on return, provided that well accepts the material and has probable use for it.

The recommended accounting procedure for rockbits is shown in paragraph 3 (vii) SOAP 5.

4.5 Rig Middle Programme/Dry Docking

Definition: Costs incurred to fulfill any contractual obligation for interim overhaul/refit or certification or repair of a rig during a drilling programme.

Policy: Costs under this heading commence when anchors are racked and rig is under tight tow from the well immediately prior to rig dry docking and end at the seventy two hour standard mobilisation period, (or lesser figure as described in paragraph 4.1) prior to anchors being set on the first well following the dry docking.

In circumstances where the rig has to be repaired due to damage caused in drilling a particular well then these costs shall be allocated directly to that well.

In other instances, the purpose of the dry docking shall determine whether the costs are spread forwards, as is usual, with a maximum of 12 months, or, in exceptional circumstances spread backwards over the wells drilled to date, again with a maximum of 12 months.

4.6 Rig Sub Assignments

Definition: The assignment by the Contractee of the rig to another party for a period of time in the Contractee's drilling programme.

In essence, the rig contractee sub assigns the rig to another party, normally to fill a gap in its drilling programme.

The rig rate charged will be subject to negotiation between the contractee and the party to which the rig is sub assigned. The contractee remains responsible to the rig owner for payments under the rig contract. A profit or loss may be made in respect of differences arising between the rig contract rate and the sub assignment rate, this will depend to a large extent on the state of the rig market.

Policy: The cut-off of costs follows the procedure described for rig moves above.

The handling of costs, (rig rate loss if applicable, mobilisation/demobilisation, rig upgrades/modifications) and any rig rate profit, if applicable, will depend on the circumstances of each case. In the absence of any specific rules, the following is intended as recommended procedure:

The Assignor company should include such costs as mobilisation/demobilisation, rig upgrades/modifications in the rig sub assignment rate. Any consequent difference between the sub assignment rate and the contracted rig rate represents a loss or profit on assignment. The intention is that costs such as mobilisation/demobilisation are charged to the sub assignee.

In circumstances where the gap in drilling programme is deliberate i.e. the contractee had no well planned at the commencement of the drilling programme and it always intended to re-assign the rig, any profit and all losses arising in respect of the sub assignment should be for the contractee's sole account.

In circumstances where the gap in drilling programme arose as a consequence of a partnership declining to drill a well (no AFE raised) even though budget approval had been given and partner approval given to the rig commitment at the outset then all costs and any profit in respect of the sub assignment should be allocated to the relevant partnership(s). The rationale being that an operator should neither gain nor lose from its position as operator.

4.7 Rig Upgrade Costs

Definition: Costs incurred in modifying or upgrading the drilling rig to meet the customers specification.

Policy: Wherever possible the rig owner should be persuaded to recover rig upgrade costs via the mechanism of a calculated increase in the rig day-rate applied to the remaining term of the rig contract.

In circumstances where the rig rate is not amended for upgrade costs, for a single well location, such upgrade costs will be charged directly to the well the rig has been hired for.

For multiple well programmes, rig upgrade costs will be spread forward over the wells drilled in the programme or 12 months whichever is shorter, on the basis of rig days.

In circumstances where an upgrade has been made specifically for one well, for example a high pressure high temperature well ('HPHT') or a deep water area well, then the total cost of the upgrade should be charged to that well, unless it can be demonstrated that other well(s) derived benefit from the upgrade (for example less drilling days) in which case the costs will spread as described above.