Standard **O**il **A**ccounting **P**rocedures
Recommended Treatment of Operator Overhead Costs

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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.

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1 Introduction

Set out below is recommended guidance on the treatment of Operator Overhead expenditures found to be controversial during Joint Venture Audits. It is not intended to be an exhaustive list, but it will simplify, clarify and streamline the charging of costs and reduce Joint Venture Audit issues. New examples will be added as necessary in subsequent amendments.

There is a simple guiding principle for the Operator when classifying costs. Is the cost for the benefit of the whole Venture? If so, then the cost will be a Joint Venture cost. If not, then the cost will probably be for the Operator's sole account. If in doubt, then the Operator should consult co-venturers before applying the charge.

2 Sole Account Charges

This is expenditure solely for the account of the Operator. The following costs will usually be for the sole account:

- Annual Accounts;
- Annual General Meetings and other shareholder meetings;
- Costs associated with changes to share capital and corporate borrowings (including interest);
- Stock Exchange listing fees and costs of publishing the share price;
- Political Contributions;
- Corporate Merger and Takeover Costs (including but not limited to fees for professional services, restructuring cost for services included in PCO or similar charging provisions, or restructuring costs for services from which Joint Ventures have not gained or will gain no benefit).

Costs for the sole account of the Operator, with specific exceptions if made in the name of an asset and/or with demonstrable venture benefit:

- Statutory Audit Fee;
- Advice on Corporation Tax;
- Charitable Contributions;
- Corporate Sponsorship and Advertising;
- Public Affairs Department Costs;
- Non Staff Entertaining.

On occasions, notwithstanding the recommendations of this SOAP, it may be reasonable to charge co-venturers costs which otherwise would be deemed for the Sole Account. Such occasions would include, but are not limited to, the protection of Responsible Operator reputation and costs incurred in the name of a particular asset. In such circumstances and where practicable it is incumbent upon the Operator to advise and seek approval from co-venturers in advance of such expenditure being incurred.

3 Joint Venture and Multi-Venture Charges

A Joint Venture Charge is expenditure specific to a Venture that can be seen to benefit from that charge. Multi-Venture Charges are for the benefit of a number of ventures which for administrative and/or practical purposes the Operator allocates between the Ventures on a fair and equitable basis.

The following costs will usually be for a Joint or Multi-Venture Account:

- Internal Audit Charges (provided the Operator releases details to co-venturers).
- Tax advice and assistance on PRT and Royalties.
- Subscription costs for UKOOA.
- UK and Overseas training. Technical conferences and meetings (but excluding long term assignments).
- All costs associated with the Main Board of Directors, Chairman, Non-Executive Directors and ex-gratia payments to Directors.

  Recommended Treatment: These costs should normally be treated as a charge for the Operator's sole account, unless, in special circumstances it can be demonstrated that provision of these services does provide some benefit to Ventures. A proportional charge may also be identified and agreed in the JOA as an element of Parent Company Overhead (PCO), Technical Service Fee (TSF) or similar.

- Redundancy Costs.

  Recommended Treatment: Allocated to the Sole or Multi-Venture accounts on the basis of the current year and up to the previous two years allocation.

- Personnel Relocation Costs.

  Recommended Treatment: Allocated so that the receiving cost centre pays. The cost should then be allocated according to the current charging methodology used for the receiving cost centre.

- Significant non-recurring expenditure e.g. office relocation, Year 2000 costs, software purchase or upgrades and a major redundancy program.

  The Operator should provide co-venturers with sufficient information to make their own decision as to the legitimacy of the charges and the allocation method used. This should involve:

  - giving co-ventures prior notice of the expected benefit to the Venture;
  - the extent of the charge, the total (gross) cost incurred and a justification of the allocation method(s) chosen.

A separate reporting line for these costs should be used in billing invoices. Acting in accordance with this SOAP does not in any way detract from the need for the Operator to obtain Operating Committee approval for the charge and the basis of allocation.

Recommended Treatment: On many occasions this expenditure is incurred so as to benefit future operations of the Operator and co-venturers. Where this can be demonstrated, allocation to Joint and/or Multi-Ventures should be based upon consideration of this future benefit by charging expenditure as incurred based on future benefits such as remaining recoverable reserves or field life. The decision tree below may be of assistance.

i Can the Operator demonstrate that the Ventures have benefited in the past or will benefit in the future from the services resulting in the expenditure?

- If no, then the charge should be to the Sole Account;
- If yes, then the charge is a valid Joint Venture charge.

ii Secondly, does the expenditure confer a future benefit?

- If no, for example, on completion of a major project or where a future programme has dramatically reduced, then where practicable, the allocation method should be based upon historic usage, preferably in line with that suggested under Redundancy Costs.
- If yes, then the allocation method should be based upon a consideration of future benefit and usage as discussed above.

- Long Term Incentive Schemes (LTISs)

  Recommended Treatment: LTISs are one element of an employee's market-based remuneration package and so are valid Joint Venture costs. Costs should be allocated to Venture or Multi-Venture accounts but only to the same extent as the other components of the employee's compensation package.

  LTISs are designed to encourage long term performance and so the accrual basis of allocation is preferable. Consideration should be given to both the period of the LTIS and to adjusting any inequality resulting from a variation in actual versus assumed share price performance.

  In many cases the cash charging basis will be acceptable since the administrative burden and uncertainties around forecasting future share prices will outweigh the benefits of the accrual method. Here costs actually incurred by the Operator and not imputed costs, should be allocated to the Venture or Multi-Venture Accounts. Again consideration should be given to both the period of the LTIS and the significance of the cost. An allocation similar to that recommended under Redundancy Costs may be appropriate.