

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. Where there is an inconsistency with the Accounting Procedure, the Accounting Procedure will prevail.

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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, it aims to simplify, clarify and streamline the charging of costs and reduce Joint Venture Audit issues. Examples will and have been 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 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. Costs associated with the following items 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 listings and publishing of share prices;
- Political Contributions;
- Corporate Merger and Takeovers (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);
- Statutory Audit;
- Investor Relations;
- Advice on Corporate Taxes;
- Set up costs for Sarbanes–Oxley / Internal Compliance;
- Transfer Pricing Uplifts;
- Business Development;

Costs normally for the sole account of the Operator can be charged to the Joint Venture if made in the name of an asset and/or with demonstrable Venture benefit. Such costs could include:

- Charitable Contributions;
- Corporate Sponsorship and Advertising e.g. Offshore Europe;
- Public Affairs Department Costs;
- Non-Staff Entertaining;
- Ongoing SOX Compliance and Internal Compliance Costs – as long as separately identifiable from the Statutory Audit Charge;
- Benchmarking;
- Cost of Internal Audit.

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 in line with the Operators standard procedures and policies.

4. Recommended Treatment for Specific Charges

- **Tax advice and assistance on PRT** (as long as Field Specific charges)
Recommended Treatment: Charge to Joint/Multi Venture Account and dependent upon Joint Venture parties obtaining access to such advice.
- **Subscription costs for Oil & Gas UK**
Recommended Treatment: Charge to Joint/Multi Venture Account.
- **UK and Overseas training**
Recommended Treatment: Charge to Joint/Multi Venture Account.
- **All costs associated with the Main Board of Directors, Chairman, Non-Executive Directors and ex-gratia payments to Directors**
Recommended Treatment: Charge to 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. PCO costs should be clearly defined with exclusions clearly identified in the JOA. Where the JOA is unclear or ambiguous, the Operator must discuss with Co-venturers the identification and treatment of such costs.
- **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.
- **Vendor Audit / Contract Compliance Costs**
Recommended Treatment: Charge to Joint/Multi Venture Account.
- **Long Term Incentive Schemes (LTIS's: Share Options / Restricted Stock / Long Term Incentive Plans)**
Recommended Treatment: to be billed through the Sole/Joint /Multi Venture Account using an appropriate allocation method on an accrued basis.

LTISs are one element of an employee's market-based remuneration package and so are valid Joint Venture costs. Costs should be allocated to Sole / 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 vesting 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 Joint / Multi Venture Accounts. Again consideration should be given to both the period of the LTIS and the significance of the cost.

- **Social Events - once a year only e.g. Christmas Party, Spring Ball**
Recommended Treatment: To be charged through the Joint Venture Accounts.
- **PAYE Settlement Agreement**
Recommended Treatment: To be charged through the Joint Venture Accounts and should follow the costs that the PSA Payment relates to.
- **Milestone Celebrations e.g. LTI Celebrations and Production Milestones**
Recommended Treatment: Charge to Joint Venture Account dependent upon Joint Venture parties obtaining benefit from such celebrations.
- **Head Office costs into the pool**
Recommended Treatment: Need to be able to justify the benefits to the Joint Ventures prior to charging to the Joint Venture; otherwise, should be charged to the Sole Account.
- **Accruals through the Joint Venture Account**
Recommended Treatment: G&A Chargeouts should be on an accruals basis. Significant over/under accruals should be adjusted for during the audit and actualisation process and charged to the prior period prior it relates to.
- **Budget Rate Chargeout and Actualisation**
Recommended Treatment: Actualisation must be completed by Q3 in the following year relating to the prior year's final costs.

5. Recommended Treatment for Significant Non-Recurring Expenditure

The Operator should discuss and obtain the approval of Co-venturers prior to charging any significant non-recurring expenditure.

Expenditure should be shown as a separate line item in Budgets and Billing Statements.

Where this type of expenditure is incurred so as to benefit future operations of the Joint Ventures some or all can be chargeable to the Co-venturers, either by allocation to Joint Ventures or by depreciation through the cost pool based on timewriting in the year of depreciation. The decision tree below may be of assistance.

- 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.
- 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 (see below)
 - If yes, then the allocation method should be based upon a consideration of future benefit and usage as discussed above.

Examples of significant non-recurring expenditure and recommended treatment:

- **Redundancy Costs**

Background :

Joint ventures enjoy the benefits of Operator's employees and the ventures are usually charged all payroll and expenses costs. Over many years the principle of those employee's severance costs and how they should be allocated has been agreed to be based upon the previous 24 months service of the employee where this was part of a significant severance program. This is still considered to be the most suitable treatment for significant severance costs. However, as the industry has sought to leverage global expertise and rationalise its costs, it is clear that there are many staff who no longer work directly for UK Ventures but are part of a large Global Centre of Expertise who will allocate their total functional cost to the regions or ventures either on a statistical key or by timewriting.

Principle :

The logic for treating these functional employees and their associated severance costs should remain consistent with the principles adopted in SOAP4 for many years. Severance should only be charged to Ventures where the Operator's employees have been working for the venture on chargeable activity.

Recommendation :

For individual matters of severance then existing treatment of in year timewriting for that individual or that individual's team timewriting should be followed.

For significant or large scale redundancy programmes, a different approach should be followed. A significant programme can be defined as one where the legislation requires the operator to undertake formal consultation with the impacted workforce.

The following groups of employee can be considered :

- 1) **Dedicated to asset / venture** – individual should be charged to ventures based upon last 24 months timewriting.
- 2) **Part of team which supports multiple ventures.** Preference would be for individual timewriting within that functional team . If that does not exist and a team timewriting approach is adopted, then that team timewriting profile for last 24 months can be used to apportion severance costs.
- 3) **Part of a global functional or overhead team which undertakes activity which is billed to the venture.** Preference would continue to be for actual timewriting to be used, however where this does not exist then using the billable non-severance costs as an analogue for proportion of severance costs to be billed would be appropriate. Eg Central HR function costs are deemed 100% chargeable costs, then all associated HR severance costs would also be charged to venture. If Central Finance costs are deemed 75% chargeable costs then associated Finance severance costs would be deemed 75% chargeable.
- 4) **Expatriate staff.** The principle of ventures paying for severance where they have previously enjoyed the benefits of the employee remains. Regardless of where the employee's home location is or where they are actually terminated, the costs of an expatriate's severance should be payable by the region where they are notified of being at risk of redundancy. With that principle of the liable region established the principles in the above 3 groups should be followed.

Audit :

It is recommended that where Operator's employ statutory audit firms to undertake G&A audit that the scope of the G&A audit and the associated report specifically reports on the Operator's adoption and compliance with the terms under SOAP4.

Budget and Billings :

Once an Operator has announced they are undertaking a significant severance program they should engage with the Venture owners to update the budget accordingly. It is recommended that Operators supply ventures with the expected total number of individuals to be made redundant and an estimate of the likely costs. Clearly until individuals are actually terminated the exact cost will not be known as this will depend on grade and length of service of the individuals concerned and owners should not withhold budget approval until this is finalised. Severance costs associated with significant programs should be reported separately on the billings or provided with additional reporting.

Given the wasting nature of Upstream assets a payback requirement should not be required for severance costs to be treated as chargeable costs.

- **Pension Payments to make-up actuarial deficit**

Recommended Treatment: to be billed through the Sole and/or Joint Venture Account on a cash basis. The allocation of which to be agreed with Partners in advance of billing and Operator should submit a plan with justification.

- **Business Improvement / System Enhancements /Upgrades**

Recommended Treatment: To be depreciated through the Joint Venture account when the implementation and upgrade is complete. Depreciation term should be in line with the Operator's policy. This would be defined as a project taking longer than 6 months to scope and implement with a materiality of over £250 thousand.

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Revision 2 issued August 2012 and prepared by:

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