<u>COPAS National Fall 2024 Emerging Issues Discussion Topics</u>

Topic 1: Project Management Charges on Invoices

- A vendor constructs an offshore location for Operator A. The vendor provides all services necessary to prepare the location and manage the overall project.
- Operator A receives a detailed invoice from the vendor, which includes labor, equipment, material, and 3rd party charges. The labor charges detailed on the invoice include administrative services in the form of project manager, administrative assistant, document control, and scheduler hours.
- Operator A charges the vendor's invoice to the Joint Account, which is governed by a 1986 Offshore Model Form Accounting Procedure.

<u>Questions</u>:

1) Is the vendor providing a service that is directly chargeable to the joint account per section II.6, *Services*, of the AP?

2) Is the vendor providing a service that is indirectly chargeable to the Joint Account and covered by the overhead rates per section III, *Overhead*?

3) Does it matter if the vendor's invoice did not include discreet lines for administrative charges, and instead included them within the dayrate or as some kind of "project fee?"

4) Does section III, Overhead, apply only to administrative functions benefitting the Operator, or does it also apply to a vendor's administrative functions that may be required for the vendor to complete a directly chargeable project?

6. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraphs i and ii of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the overhead rates. The cost of professional consultant services or contract services of technical personnel directly engaged in the operation of the Joint Property shall be charged to the Joint Account if such charges are excluded from the overhead rates.

9. Legal Expense

Expense of handling, investigating and settling litigation or claims, discharging of liens, payments of judgments and amounts paid for settlement of claims incurred in or resulting from operations under the Agreement or necessary to protect or recover the Joint Property. except that no charge for services of Operator's legal staff or fees or expense of outside attorneys shall be made unless previously agreed to by the Parties. All other legal expense is considered to be covered by the overhead provisions of Section III unless otherwise agreed to by the Parties, except as provided in Section I, Paragraph 3.

III. OVERHEAD

As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge the Joint Account in accordance with this Section III.

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the overhead rates provided for in this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

i. Except as otherwise provided in Paragraph 2 of this Section III, the salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property:
( ) shall be covered by the overhead rates.
( ) shall not be covered by the overhead rates.

ii. Except as otherwise provided in Paragraph 2 of this Section III, the salaries, wages and Personal Expenses of Technical Employees and/or costs of professional consultant services and contract services of technical personnel either temporarily or permanently assigned to and directly employed in the operation of the Joint Property:
( ) shall be covered by the overhead rates.
( ) shall not be covered by the overhead rates.

Topic 1: Project Management Charges on Invoices (continued)

- The labor charges detailed on the invoice include administrative services in the form of project manager, administrative assistant, document control, and scheduler hours
- Operator A charges the vendor's invoice to the Joint Account, which is governed by a 1986 Offshore Model Form Accounting Procedure.
- The Operating Agreement includes a provision to clarify Section III, Overhead, of the AP. This provision states,

  > "The Major Construction rates shall provide for all personnel above the Project Manager level and all other administrative functions and associated cost indirectly serving the project including, but not limited to, cost for accounting, services personnel, treasury, administrative, senior management, and other support services provided by the Operator."

Questions:

1) If the vendor's service is part of a Major Construction project, are the administrative services included on the invoice directly chargeable or covered by the overhead rates?

2) If covered by the overhead rates, would costs for the vendor's "project manager" be directly chargeable to the Joint Account?

Topic 2: Rig & Material Administrators

- A vendor provided drilling services at an offshore location for Operator A. The vendor includes rig administrators and materials administrators as part of their drilling service. These administrators coordinate all material orders and movements on the drillship.
- Operator A charges the vendor's invoice to the Joint Account, which is governed by a UOA with an Exhibit C 1986 Accounting Procedure.
- Exhibit C states in section III, Overhead, "as compensation for administrative, supervision, office services and warehousing costs, Operator shall charge the Joint Account in accordance with Section III."

Questions:

1) Are the rig and material administrator costs included on the drilling invoice directly chargeable to the Joint Account?
2) Are the rig and material administrator considered administrative services and should be covered by overhead per section III?
3) Does it matter if the rig and material administrators are identified in the drilling contract and are integral to the vendor's drilling services?
4) Does section III, Overhead, specifically apply to the Operator's administrative functions?
5) Does it matter if the vendor's invoice did not include discreet lines for administrative charges, and instead included them within the dayrate or as some kind of "project fee?"

1986 Accounting Procedure, Section III, *Overhead*

III. OVERHEAD

As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge the Joint Account in accordance with this Section III.
Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the overhead rates provided for in this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

i. Except as otherwise provided in Paragraph 2 of this Section III, the salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property:
( ) shall be covered by the overhead rates.
( ) shall not be covered by the overhead rates.

ii. Except as otherwise provided in Paragraph 2 of this Section III, the salaries, wages and Personal Expenses of Technical Employees and/or costs of professional consultant services and contract services of technical personnel either temporarily or permanently assigned to and directly employed in the operation of the Joint Property:
( ) shall be covered by the overhead rates.
( ) shall not be covered by the overhead rates.

Topic 2: Rig & Material Administrators (continued)

1986 Accounting Procedure, Interpretive

III. OVERHEAD

GENERAL

Overhead is a provision whereby those costs incurred above the lease operating level which generally include administrative costs, supervision, office services and warehousing costs are combined into a single overhead allowance for a given type of operation. This overhead charge shall be in lieu of costs and expense of all offices and salaries or wages plus applicable burden and expenses of all personnel except those directly chargeable under Section II, Paragraph 2A.

Administrative costs for overhead purposes are defined as those general costs attributed to executive and administrative functions incurred by the Operator at the home, divisional, area, regional, or similar administrative office above the operating level serving, indirectly, the development and producing operations. - In the case of the large or "major" companies, the administrative function can be located in more than one office, while in the case of the smaller or "independent" companies the function is usually located at the home office. Administrative costs applicable to development and producing)n operations include the overhead of the related facility operations, such as gas systems and plants, salt water disposal systems, additional recovery systems, etc., if such other facility operations are administered b~ a common staff with the development and producing operations. Administrative overhead costs of downstream operations, such as refinery, sales, oil and gas transportation, oil purchases and sales, manufacturing and other operations not directly associated with producing operations should not be included in administrative costs. In determining the apportionment of administrative costs of any particular account, equitable weight should be given to all functions.

Supervision and office services performed at the area, regional or district level which are incurred while **drilling and producing and are of such a general nature that all wells, leases and facilities in the area benefit** proportionately, are recognized as being included in the overhead rate.

These expenses consist of the salaries and expenses of the production superintendent and other employees serving properties in the same operating area whose time is not charged directly to the properties.

Costs of field operated and maintained buildings permanently staffed by field employees responsible for directly operating leases and units, and whose salaries and wages are charged directly to the leases and units served by the building and associated facilities are direct charges to the Joint Properties served by the field employees.

Warehouse operation and maintenance expenses represent Operator's cost of storing and handling that Material for which it is not practical nor feasible to purchase directly from outside sources at the required time of need.

The warehouse operation and maintenance expenses include costs such as: salaries and related payroll burden of warehousemen or clerks receiving and disbursing stock items, depreciation on material storage facilities, loading, unloading and transportation in to stocking point, maintenance and care of stock and storage facilities and any other cost incurred directly for the purpose of warehousing Material.

For further amplification, refer to COPAS Model Form Interpretation 21, *Overhead Principles* on Overhead.

COPAS National Fall 2024 Emerging Issues Discussion Topics

Topic 3: EI Email Enquiries – Your Emerging Thoughts Discussed!

- **Exception Materiality vs. Immateriality**
  Can an operator reference immateriality in response to a valid audit exception? If so, do operators and non-operators define materiality the same?

- **Time Spent Serving on Drafting Teams**
  How much time will be required to commit when serving on future teams so we can determine if any will fit into our busy schedules? How much time do members typically spend when serving on COPAS teams?

- **Revenue Deductions for Future P&A Costs**
  We have a situation with an operator deducting an amount from monthly revenues for future plugging and abandonment costs. This was done without prior approval or any indication of a planned abandonment. They are collecting this over multiple years with no immediate abandonment plans ($600 gross per month, until $100K is collected).

  The operator provided a memorandum to the working interest owners of their properties, indicating "in the last several years, various onshore operators have implemented plugging and abandonment funds…." They state that AAPL model form operating agreements contain provisions that require the parties to pay their share of expense as well as their share of a defaulting non-operator. Essentially they are asserting that they are collecting these funds to lessen the impact of the possibility of a defaulting non-operator.

  Is anyone else familiar with such a situation? How have you handled it, both from an accounting standpoint and in managing your relationship with that operator?

- **VRU & IA Purchases Related to Methane Regs: capitalizing or billing out as LOE**
  We are wondering how other companies and COPAS will treat the VRUs (Vapor Recovery Unit) and IAs (Instrument Air) from the recent federal methane requirements for already producing wells. Are others capitalizing these costs with new AFEs or putting them to LOE?

- **MCO Charged at Well Level**
  Exception: Operator calculates major construction overhead at an individual well level rather than at a project level on a tank battery facility. The Accounting Procedure indicates total cost, for major construction overhead purposes, shall mean the gross cost of any one project and the component parts of a single major construction project shall not be treated separately. Since the construction of the tank battery was one individual project, major construction overhead should be calculated as such, at the project level, then allocated to the wells utilizing the tank battery.

  Response: Joint Operating Agreements and their attached Accounting Procedures direct the accounting for operations at the individual well level. For the purpose of the Accounting

Procedure, "gross costs of any one project" can only mean the portion of the costs received by the individual well governed by the agreement – the Accounting Procedure has no authority in determining what constitutes a project at a level higher than this. Major construction overhead percentages are properly applied to the gross costs charged to an agreement.

Is the Operator correctly calculating the major construction overhead?

MFI-58, COPAS 2022 Model Form Accounting Procedure Interpretation

The rates apply to the total gross cost charged under Section II (*Direct Charges*) for each Major Construction or Catastrophe project. To calculate Major Construction Overhead, the components of a single Major Construction project must be aggregated, and the cost of drilling and downhole well operations and cost of purchasing and installing pumping units and downhole artificial lift equipment are excluded.

A Major Construction (or Catastrophe) project may involve multiple properties subject to different Agreements. In that case the direct costs will be allocated to the properties. The overhead tranches are applied on an Agreement-by-Agreement basis, not a well or total project basis. For example, assume the Operator constructs a facility with total direct costs of $2,000,000, serving five wells, and each well is served equally. Four wells are under one Agreement and the fifth well has a separate Agreement. Of the $1,600,000 allocated to the first four wells, the first $100,000 will be charged overhead at the negotiated rate under (i) above, the next $900,000 will be charged overhead at the negotiated rate under (ii) above, and the final $600,000 will be charged overhead at the negotiated rate under (iii) above. The single well under a separate Agreement is allocated $400,000. If the Accounting Procedure covering that well has the same tranches, it will be charged overhead at the negotiated rate under (i) above on the first $100,000 and at the negotiated rate under (ii) for the remaining $300,000.

MFI-51, COPAS 2005 Model Form Accounting Procedure Interpretation

Total cost shall mean the gross cost of any one project. For the purpose of this paragraph, the component parts of a single Major Construction project shall not be treated separately, and the cost of drilling and workover wells and purchasing and installing pumping units and downhole artificial lift equipment shall be excluded. For Catastrophes, the rates shall be applied to all costs associated with each single occurrence or event.

The overhead rates are applied to the total gross cost of a single project. Total gross cost means all costs exclusive of overhead charged to the project, reduced by the credits for refunds or returns. Additions, modifications, enlargements, abandonment, and/or reclamation required at some date subsequent to the physical completion of the project would constitute a separate project.

Costs of constructing and installing steam generators, CO_2 Plants and/or injection facilities are considered eligible for Major Construction Overhead, provided they meet the dollar threshold. Costs of purchasing and installing pumping units and downhole artificial lift equipment is not considered Major Construction because they are routine installations that do not cause the Operator to incur significant incremental overhead costs.

Topic 4: Land Related Costs Chargeability

- Administrative personnel in the corporate office use tools like MS Excel, MS Outlook, Spotfire, Tableau, etc. to perform tasks like aggregate well file data, prepare daily operations reports, and provide daily reports to management and joint interest owners.
- There are service companies offering software solutions to automate these tasks, such as WellDrive and WellEZ

<u>Questions</u>:

1) What types of software costs are directly chargeable to a Joint Account?

2) How do you determine if a software solution is merely a convenience for the Operator or is of direct benefit to the Joint Account, and does this matter?

3) In the example situation above, is the cost of these software solutions directly chargeable to the Joint Account?

   - Does it matter who is using the software or application?

   - Does it matter how the software or application is used?

Topic 4: Land Related Costs Chargeability (Part 2)

- Two wells in a unit were drilled & completed, and have produced for a year.
- Two new wells are being drilled. While going through the Division Order Title Opinion ("DOTO") process on the two new wells, an issue is uncovered that causes the operator to amend the decks on the two producing wells along with the decks for the two wells currently being drilled.

<u>Questions</u>:

1) How should the DOTO costs be charged?
   a) To the two new wells only.
   b) To all 4 wells, by well count.
   c) To all 4 wells, by the number of lateral feet each well has in the affected unit.
   d) Some other method (please explain).

Original DOTO Cost:	150,000				
			Lands from		
Original Allocation:		Unit A	Unit B	Unit C	
- Well 1	75,000	37,500	37,500	-	<- these wells paid $75k ea for DOTO
- Well 2	75,000	37,500	37,500	-	
Supplemental DOTO Cost:	50,000				
			Lands from		
Original Allocation:		Unit A	Unit B	Unit C	
- Well 3	25,000	18,750	-	6,250	<- these got the benefit of the original DOTO and only paid $25k ea
- Well 4	25,000	18,750	-	6,250	

Topic 5: Abandonment Costs – Technical Services

- Vendor provides offsite engineering service to Operator A during P&A operation.
- Operator A charges the vendor's invoice to the Joint Account, which is governed by a 1998 PTAP Accounting Procedure.
- Section III, *Overhead*, indicates the costs for technical personnel assigned to or employed in the operation of the Joint Property shall be covered by the overhead rates.
- Section II.14, *Abandonment And Reclamation*, indicates costs incurred for abandonment and reclamation are directly chargeable to the Joint Account.

Questions:

1) Is the invoice for offsite engineering service correctly charged to the Joint Account? Why or why not?

2) MFI-39, *1998 Project Team Model Form Accounting Procedure Interpretation*, indicates all well abandonment costs incurred in meeting regulatory requirements are directly chargeable to the Joint Account.

   a) Does this literally mean ALL abandonment costs (if necessary to satisfy regulatory)?

   b) Does section 14 supersede the selections made in section III?

   c) Would offsite technical service costs be chargeable under this section II.14 if they are related to P&A work?

ii. Except as otherwise provided in Paragraphs 1 and 3 of this Section III, the salaries, wages, related payroll burden and Personal Expenses of Technical Employees, and/or costs of professional consultant services and contract services of technical personnel either temporarily or permanently assigned to and directly employed in the operation of the Joint Property

- o shall be covered by the overhead rates
- o shall not be covered by the overhead rates

14. ABANDONMENT AND RECLAMATION

Costs incurred for abandonment and reclamation of the Joint Property, including costs required by governmental, regulatory, or judicial authority

All well abandonment costs incurred in meeting regulatory and lease requirements in the abandonment of the Joint Property are proper charges to the Joint Account. These costs include, but are not limited to, the costs to abandon platforms and other offshore structures and the costs to abandon wells and onshore facilities including surface restoration costs.

COPAS National Fall 2024 Emerging Issues Discussion Topics

Topic 6: Federal Methane Fee Regulations Update

Guest Presentation by:

Mr. Dan Romito, Consulting Partner at Pickering Energy Partners.

Dan Romito is a consulting partner at Pickering Energy Partners focusing on quantitative ESG strategy and implementation. Throughout his career, Dan has advised several hundred private companies, public issuers, and asset managers on how to optimize capital deployment strategies, pursue quality pools of capital and employ ESG-related directives. A substantial portion of his experience has centered on helping the Energy, Industrial, Materials, and Utility space navigate ESG-focused data providers, frameworks, disclosures, and the corresponding investor landscape. His experience and research on ESG, Index/ETF Ownership, and Shareholder Activism has been featured in a variety of global periodicals, including Harvard Business Review, the Harvard Law School Forum on Corporate Governance, CNBC, Bloomberg, Global Investor Magazine, and IR Magazine. Dan received a BA from the University of Chicago, an MBA in Finance from DePaul University, and is a professor at Marquette University where he teaches ESG implementation, strategy, and certification.

Pickering Energy Partners
pickeringenergypartners.com
dromito@pickeringenergypartners.com
281-661-1747