

**2018 OCSAB Summer Seminar**

**Industry Panel Discussion**

**COPAS Audits – Pitfalls and Potential  
Solutions**

August 14, 2018

 **Overhead on Large, Single-Line Costs**

 **Barriers to Audit Resolutions**

 **Role of the Landman in the Audit Process**

As compensation for costs not specifically identified as chargeable to the Joint Account pursuant to Section II (*Direct Charges*), the Operator shall charge the Joint Account in accordance with this Section III. The Parties specifically recognize that functions described in this Section III shall be directly chargeable when performed by personnel assigned to a Feasibility Team or Project Team and within the scope of work, as approved by the Parties under the Agreement. Functions compensated by the overhead rates regardless of whether they are performed by the Operator, Operator's Affiliates, or third parties and regardless of location, include, but are not limited to, the following:

- physical inventories not chargeable under Section V (*Inventories of Controllable Material*)
- procurement
- administration
- accounting and auditing
- pipeline nominations and scheduling
- human resources
- management
- supervision not directly charged under Section II.2 (*Labor*)
- legal services not directly chargeable under Section II.9 (*Legal Expense*)
- handling taxation matters, other than those costs permitted under Section II.10 (*Taxes and Permits*)
- permitting and regulatory work, to the extent not requiring Technical Services, including: preparation and monitoring of permits and certifications; preparing regulatory reports; reviewing, interpreting, or submitting comments on Laws or proposed laws; Off-site appearances before, or meetings with, governmental agencies or other authorities having jurisdiction over the Joint Property or Joint Operations
- land and division order services.

## 1. OVERHEAD – PROJECT AND OPERATING

A. As compensation for costs incurred but not chargeable under Section II (*Direct Charges*), the Operator shall charge the Joint Account at the following rates:

**Project Rate**  percent ( \_\_\_ %) of the directly chargeable costs associated with a single activity or operation costing in excess of the Operator's expenditure limit in the Agreement and requiring approval under the Agreement. The project rate shall also apply to an activity or operation that costs in excess of such expenditure limit and would require approval were it not for the discretionary authority granted to the Operator under the Agreement. If the Agreement does not contain an expenditure limit, overhead shall be assessed at the Project Rate for any single activity or operation costing in excess of \_\_\_ dollars (\$ \_\_\_). For the purpose of this paragraph, the component parts of a single activity or operation shall not be treated separately.

**Operating Rate**  percent ( \_\_\_ %) of the directly chargeable costs incurred in activities and operations under the Agreement, except those subject to the Project Rate.

B. Expenditures to which the project overhead and operating overhead ***do not apply*** are:

- Material salvage credits
- insurance recoveries
- costs covered by Section II.1 (*Rentals and Royalties*)
- costs covered by Section II.9 (*Legal Expenses*)
- the value of substances purchased for enhanced recovery
- payments to third parties in settlement of claims
- property taxes, ad valorem taxes and other tax and assessments levied, assessed, and paid upon the mineral interest in and to the Joint Property
- production handling fees, infrastructure access fees, and/or operating and maintenance expenses fees paid to owners or operators of Offsite Host Facilities
- deferred production payments paid by Operator on behalf of the Parties
- quality bank adjustments paid by the Operator on behalf of the Parties
- insurance acquired for the Joint Account other than workers' compensation and employer's liability insurance

## **2. AMENDMENT OF OVERHEAD RATES**

The overhead rates provided for in this Section III may be amended from time to time only by mutual agreement of the Parties if, in practice, the rates are found to be insufficient or excessive.

**MARINE WELL  
CONTAINMENT  
C O M P A N Y**

Marine Well Containment Company  
9807 Katy Freeway, Suite 1200  
Houston, TX 77024  
Phone# (281)820-8800 Fax# (281)820-8899

**INVOICE**

Date	[REDACTED]
Invoice #	[REDACTED]
Customer ID	[REDACTED]

<b>Bill To</b>
[REDACTED]

[REDACTED]

Well Description	Well Number	Payment Terms	Due Date
Mississippi Canyon Block 1 [REDACTED]	OCS-G [REDACTED]	Net 05 Days	01/09/2017

Item	Description	Amount
JO	Well Fees - C [REDACTED]	14,000,000.00
<b>Total</b>		<b>14,000,000.00</b>

Remit Wire Payment to:  
JP Morgan Chase Bank NA  
Marine Well Containment Company LLC  
Account# 38836199 0  
ABA# 0210 00021

Remit ACH Payment to:  
JP Morgan Chase Bank NA  
Marine Well Containment Company LLC  
Account# 388361990  
ABA# 111000614



# Claims Resolution

- ☉ On and on and on and on and on and on.....
  - ☉ “Issue trading,” “pot settlement,” or involvement of operations personnel
  - ☉ Mediation, arbitration
  - ☉ Sometimes.....resolution is NEVER reached
- Most Accounting Procedures require the Operator to respond within 180 days, but there are no “teeth” in the requirement

“The Operator shall reply in writing to an audit report within 180 days after receipt of such report.” *1984; Article 1.5(B)*

# The COPAS 2012 Accounting Procedure is an improvement

- ☉ Audit Report due within 90 days after analysis and testing;
- ☉ Operator response due within 180 days;
- ☉ Non-Operator response due within 90 days;
- ☉ Operator response due within 90 days;
- ☉ If deadlines not met, or if issues are outstanding after 15 months, any party can call for one or more Audit Resolution Conferences;
- ☉ If these negotiations fail, outstanding issues will be submitted to mediation
- ☉ Provides for “tolling” of statutes of limitations while non-operator is adhering to response time requirements

# The COPAS 2005 Accounting Procedure addresses the resolution problem much more head-on than COPAS 2012

- ☉ Audit Report due within 90 days after analysis and testing;
- ☉ Operator response due within 180 days; *if not, interest owed*;
- ☉ Non-Operator response due within 90 days;
- ☉ Operator response due within 90 days; *if not, interest owed*;
- ☉ If deadlines not met, or if issues are outstanding after 15 months, any party can call for one or more Audit Resolution Conferences;
- ☉ If these negotiations fail, outstanding issues will be submitted to mediation
- ☉ *Optional Death Penalty*
- ☉ Provides for “tolling” of statutes of limitations while non-operator is adhering to response time requirements

## ➤ The optional “Death Penalty”

*(Optional Provision – Forfeiture Penalties)*

*If the Non-Operators fail to meet the deadline in Section I.5.C, any unresolved exceptions that were not addressed by the Non-Operators within one (1) year following receipt of the last substantive response of the Operator shall be deemed to have been withdrawn by the Non-Operators. If the Operator fails to meet the deadlines in Section I.5.B or I.5.C, any unresolved exceptions that were not addressed by the Operator within one (1) year following receipt of the audit report or receipt of the last substantive response of the Non-Operators, whichever is later, shall be deemed to have been granted by the Operator and adjustments shall be made, without interest, to the Joint Account.*

# Barriers to Resolution

## Operators

- ☒ Lack of staff
- ☒ Lack of commitment
- ☒ Lack of documentation
- ☒ Lack of operational support
- ☒ Inexperienced auditors
- ☒ Low priority to refund \$\$\$

## Non-Operators

- Lack of staff
- Lack of commitment
- Burdesome documentation
- Lack of operational knowledge
- Inexperienced hosts
- Spend even more money ???

**Comments?**

## Role of the Landman in the JV Audit Process

© Who negotiated the agreements?

© Who knows the agreements?

© Who can explain the intents?

© Who knows the unique and quirky provisions?

© Who knows all the applicable agreements?

© Who should interact with the accounting and auditing groups?

## Role of the Landman in the JV Audit Process

**Comprehensive preliminary work is essential to the success of an Expenditure Audit**

**Guidance from Negotiators can prove to be an invaluable resources to the auditors and contribute significantly to an efficient & productive review**

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