



Audit of Oil Concession Contracts – Case Studies

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**International Centre for Environment Audit and Sustainable
Development
Jaipur**



Mandate for audit

- **Article 20 of Chapter VI – Entities subject to the audit of the institution of State Audit Law**
“The following are the entities subject to the audit of the Institution:
 - 4) The bodies to whom Government has granted a concession to exploit a public utility or natural resources”
- **Enabling provision in Production Sharing Contract:**
“Duly authorised auditors of the Government shall have the right at all reasonable times to have access to and inspect, test and audit the works, equipment, operations and financial books, records and registers of the contractor relating to its activities for the five years immediately preceding under this agreement including the transportation and marketing of hydrocarbons. The contractor shall furnish to the duly authorised auditors of the Government who effect the inspection, testing or audit all necessary assistance and adequate facilities for the proper discharge of their duties.”



Mandate for audit (continued)



- **Functions of Finance Sub Committee of the Joint Management Committee**

“Discussions with the State Audit Institution and the external auditor about the audit plans and results, any problems or reservations arising and any other matters which the State Audit Institution or the external auditor wishes to discuss.”

- **Audit to be carried out as per International Accounting and Auditing Standards and corresponding financial regulations and according to the guidelines issued by the International Organisation of Supreme Audit Institutions as per provisions of *Article 21 of State Audit Law*.**
- **Chairman can entrust the audit to external auditors after laying down the scope of such work and their reports shall be submitted to the State Audit Institution as per provisions of *Article 22 of State Audit Law*.**



Audit Objectives

- Objectives of audit are to review the overall operations of the concessions to ascertain whether:
 - the concessions are operated in accordance with the respective Exploration and Production Sharing Agreements (EPSA) and Oil/Gas Sales Agreement;
 - the statements of the recoverable costs reflect the true and fair picture of the costs incurred and recoverable under the EPSAs;
 - Allocation of production to costs and profit is in accordance with the EPSAs;
 - Contracts have been awarded and executed on sound commercial principles;
 - Taxes and duties have been correctly assessed where due to be paid;
 - Obligations relating to protection of environment and abandonment plans
 - There are proper and adequate internal control systems and procedures;



Planning the audit

□ Documents to be studied:

- Provisions in Exploration and Productions Sharing Agreements relating to the following:
 - Term of Agreement and its impact on payment of bonuses if any and rentals, relinquishments of blocks and renewal of agreement;
 - Minimum work and financial obligations of the contractor and execution of work programs and budgets along with Appraisal and Field Development Plans;
 - Cost recovery from Cost Oil/Gas/Condensate including provisions regarding taxation, contribution to abandonment fund, contribution for utilisation of transmission facilities, purchase and disposal of cost recovered assets;
 - Profit Oil/Gas/Condensate sharing between Government and Contractor including measurement of hydrocarbons and provisions of oil/gas sales agreement .
 - Crude oil transportation and handling agreement
 - Joint Operating Agreement if any



Planning the audit

Documents to be verified

- Quarterly Progress Reports including Statement of Recoverable costs
- Annual Reports
- Financial Statements including Annual Statement of Recoverable Costs
- Work Program and Budget
- Proceedings of Management Committee including those of Finance, Human Resource, Tender and Technical Sub Committees
- Five year program for anticipated and feasible capacity.



Audit Issues relating to Term of Contract



- **Effective Date (ED) for commencement of contract determines the following compliance with which needs to be verified in audit:**
 - **Maximum period of contract and extension if producing petroleum;**
 - **Date for commencement of work by contractor;**
 - **Initial exploration Period and work to be carried out during the period;**
 - **Extension of period with extension fee or surrender of blocks after initial exploration period;**
 - **Relinquishment schedule in stages prescribing retention limits of blocks after fixed periods. Eg. 25% after 15 years**
 - **Voluntary relinquishment subject to completion of work**



Audit issues relating to payments to be made

- **Bonus**
 - Signature Bonus
 - Bonus on extension
 - Discovery Bonus
 - Exploitation Bonus based on net production levels reached
- **Rentals**
 - Annual rental prior to discovery
 - Annual rental after commercial discovery
- **Audit to check compliance with the due date for payment and the amount paid to government**



Audit issues relating to Operations



- **Effectiveness of operations to be assessed through:**
 - Compliance with approved budget and work program
 - Effectiveness of Granting approval for budget, work program, deviations from program, well clearance, determination of allowable production, rules and procedures to be followed by Management Committee
 - Meetings of Management committee and sub committees.
 - Flaring of associated gas limited to what is left after consumption for testing, pressure maintenance and delivery to government



Audit issues relating to recoverable costs



- Verify whether the costs claimed are subject to:
- Limits if any prescribed for recovery;
- Verify whether the following are excluded:
 - Bonus if any paid to government;
 - Omani or foreign income tax paid;
 - Sales expenses for marketing oil outside Oman or beyond delivery point;
 - Interest charges on funds borrowed;
 - Depreciation charges;
 - Amortisation of capital.



Audit issues relating to recoverable costs



- Check whether the costs claimed are:
 - Directly identifiable with operations;
 - Actually incurred;
 - Fair and reasonable and do not exceed current competition charges by unaffiliated third parties;
 - Overheads are limited to those reasonably attributable to operations and generally in practice in petroleum industry;
 - Does not include mark up or commission on equipments claimed by contractor;
 - Audit opinion by external auditor limited to whether the claims are substantiated by books of accounts



Audit issues relating to recoverable costs



- Sample testing of procurement of goods and services to see whether systems promote getting most competitive offers
- Vouching of personnel payments to see whether laws of Sultanate of Omani complied with
- Ownership of cost recovered assets and remittance of proceeds of disposal
- Contract approval process followed by Management Committee
- Contributions towards site restoration fund



Audit issues relating to sharing of production



- **Verify adherence to sharing ratio:**
 - Cost petroleum and Profit petroleum
 - Associated gas utilisation and delivery to government
 - Non associated gas sharing
 - Condensate sharing
 - Utilisation of natural gas for production of liquefied natural gas
 - Verification of underlift, overlift and make-good quantities
- **Verify wellwise production data and meter readings at sales point**
- **Verify the correctness of prices adopted and acceptance by government and market price comparison**
- **Verify correctness of calculation of taxes**



Audit issues relating to assignment of interest and other issues



- **Approvals for assignment of interest from Government**
- **Abandonment Plans**
- **Dispute settlement procedure**
- **Material breaches and default if any and the action taken**
- **Health, Safety and Environmental issues**



Thanks!