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Accounting Procedures for Joint Venture Operations in the Oil Industry

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In the crude oil producing industry, ownership of a part-interest in a lease or property as a partner, joint-venturer, or on some other basis is quite common. This type of operation is extremely attractive to the smaller company which is actively engaged in the search for and production of oil. It allows the company to take a part interest in many drilling operations and thus spread the risk of "too-many dry holes."

When property is owned by two or more interests, various documents are executed by the interest-owners. These instruments set out the status of ownership as to the joint venture as well as other features of ownership. The development and operation of the properties may be either a part of that initial instrument or it can be covered by a separate agreement. In either case the development and operation agreement should include accounting procedures.

In this type of operation, one of the interest owners is designated as the operator of the properties. It usually becomes his responsibility to develop and operate the property in accordance with the operating agreement. The operator renders billings to the other joint-owners for their proportionate part of expenses and capital outlay in accordance with the accounting procedures that have been adopted. If the well is completed as a producing well, it becomes the responsibility of the operator to account to the joint owners for their respective shares of oil and gas production.

The oil company which participates in these joint operations as the operator of the properties must design its accounting records to give each of the other joint venturers a complete and adequate accounting on income, expenses and capital outlay on each well drilled on each lease and/or in each unit.

One way of conveying this information to each non-operator is to send monthly statements supported by copies of the invoices from each vendor. Where there are several partners involved in a joint venture, this can become a tedious and time-consuming task. Then too, each co-owner has to break the expenditures into the required categories for income tax purposes and for his permanent record of well costs. The accounting and billing on this type of operation can be successfully and adequately handled by utilizing the facilities of a computer service center.

If the operating company avails itself of this type of service, codes are assigned and programmed into the computer for the different types of expenditures, such as:

1. Leasehold Costs
2. Intangible Development Costs
3. Lease and Well Equipment
4. Lease Operating Expenses
5. Other Charges

When code data is put into the computer, it will print out for each lease a description of type of work performed and summarize for the partners the amount of money spent in each category. If at any time the person receiving the billing feels that the description is inadequate, he can either ask for a copy of the invoice or examine it at the office of the operator. This eliminates the need to make duplicate copies of the invoices or to type detailed descriptions of each invoice. Procedures which might be followed in this kind of operation are outlined below.

Vendor Invoices

Invoices, when received by the accounting department, are reviewed for the proper approval and are checked for mathematical accuracy. The accountant then codes the charges to the proper account.

The remittance advice portion of a four-part voucher check is prepared for each vendor. For invoices coded for the Joint Venture Clearing Account, the following information is noted on the remittance advice: expense month (month for which charge

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is made), lease number, vendor invoice number, code number describing the type of expenditure, amount, and vendor name. The fourth copy of the voucher check is then removed from each voucher set. A total is run on these vouchers and, together with a batch control sheet, they are forwarded to the service center. This amount becomes the source of a standard journal entry debiting the Joint Venture Clearing Account and crediting Vouchers Payable at the end of the month.

The remainder of the voucher set is filed alphabetically within due date in the open voucher file. Weekly, the accountant reviews the open voucher file to select those vouchers due for payment. The voucher check is prepared and forwarded to the authorized persons for signature. The signed checks are returned to the accountant who marks the invoices paid, and distributes the check copies as follows:

Copy 1—mailed to vendor
Copy 2—attached to cancelled invoice and placed in alphabetical vendor file
Copy 3—placed in numerical file

At the end of the month, the "net amount", "discounts lost", and "net cash" amounts on the third copy of the checks released during the month are totaled. These totals will be entered on a standard monthly journal entry debiting Vouchers Payable and Discounts Lost and crediting Cash. The usual joint venture agreements provide that outside interests are entitled to credit for cash discounts on their portion of purchases whether or not the operator takes advantage of the discount privilege.

Payroll

The manner in which payroll is handled will be determined by the operating agreement on each joint venture enterprise. The operating agreement can call for specific payroll, payroll taxes, and employee benefits to be a charge to the joint venture account. If the accounting procedure calls for a proration of field expenses (including payroll), the field employees will fill out and submit time sheets showing the type of work done, the lease on which work was performed, the number of hours worked, and the hourly rate. These time sheets are approved by the field supervisor and are forwarded to the accounting department. Payroll checks are coded to the proper account, and payroll chargeable to the joint venture accounts becomes the supporting data for a debit to the Joint Venture Clearing Account. At the end of the accounting period, this too, becomes a part of the monthly billing to each participant in the joint venture activity.

Other Monthly Journal Vouchers

The operating agreement can designate that the billings to the participants in the joint venture will include so much per well per month for administrative overhead for operating a well and a specific amount for drilling a well—beginning from the date the well is spudded until it is either put on production or is plugged and abandoned as a dry hole. These charges can be handled on a transmittal slip to the service center with a journal entry on the books debiting the Joint Venture Clearing Account and crediting Rebilled Overhead.

Material Transfers

When any material or equipment is transferred from one lease to another, a two-part material and equipment transfer form is prepared. One form is submitted from the field by the supervisor who authorizes the transfer. A full description of the transferred item is to be included on the form with a notation as to the condition of each item. Condition codes used are as follows:

A—New—100%
B—Good—75% (Second Hand, Usable)
C—Fair—50% (Usable, if repaired)
D—Poor—25% (Defective)
E—Junk

The person in authority receives both copies of the transfer form and prices out the various items listed. Prices used are based on current prices for each specific item listed. After amounts have been entered on the form, both copies go to the accounting department where one copy is filed in numerical order and the other copy is used for the preparation of a standard monthly journal entry to record the transfer.

This information is submitted to the service center to become a part of the monthly billings to the joint owners.

Joint Owner Receivables

At the time the transmittal sheets on vendor's invoices, payroll, rebilled overhead, and material transfers are sent to the service center, a transmittal sheet covering all payments received from the joint owners during the month is included. The service center processes all of this information and the result is an invoice to each joint owner showing his share of expenditures for the current month and payments received during the month on previously billed invoices. Supporting this billing is a detailed analysis for all expendi-

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As will be seen from the above, basically the Payroll factor will be the same for uniform division of income purposes at it is for state payroll tax purposes.

Sales Factor

Article IV of the Compact delineates the allocation of sales of other than tangible property and no problem is presented. At present writing, however, some difficulty is presented in the case of sales of tangible property. The primary rule is that sales will be allocated on the basis of destination with two exceptions:

> Sales emanating from facilities located in a particular state will be attributed to that state, rather than the state of destination, in instances where:
>
> (a) The U. S. Government is the purchaser, or
>
> (b) The seller is not taxable in the state where the purchaser is located.

Article IV-3 of the Compact indicates that a seller *is* taxable in another state if in that state he is subject to a net income tax, a franchise tax based on the privilege of doing business or measured by net income, a corporate stock tax, or the state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does. This last category presents difficulty, but in discussions with tax authorities that have already adopted the Uniform Division of Income for Tax Purposes Act, and in the course of research on the subject it would seem that we must refer to Public Law 86-272. In other words, if orders are filled out of a warehouse in State A and are delivered to a purchaser in State B that does not have an income tax, the receipts are allocable to State B provided State B has jurisdiction to tax the seller (e.g., Seller has a research laboratory in State B) and has not exercised that jurisdiction. If, however, the goods are delivered to a state that has an income tax but, by virtue of Public Law 86-272, taxpayer can establish that sufficient nexus is not present to force him to comply with the taxing laws of that state, he is *not* taxable in the state of the purchaser. Such sales are therefore attributed to the State from whence the goods were shipped.

While all of the foregoing is, as indicated at the outset, a very brief resumé of current state tax problems, it is sufficient to alert both taxpayers and accountants to the necessity of keeping abreast of new legislation. It will only be in rare instances that record keeping will not have to be revised in a multistate business operation. Such revisions should be effected promptly to ameliorate the situation.

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tures for each lease or unit which has been printed out by the machine. The monthly billing that is sent to the joint venturer has been prepared by the machine in such a manner that the co-owner can see at a glance what part of the indebtedness represents current billing and what portion is a past-due obligation.

After these billings have been completed, the machine will prepare a statement for management aging the joint owner receivables. It will print out the information needed by management in analyzing the accounts receivable from each of their joint venturers.

From the data processed by the service center, a journal entry is prepared debiting the Joint Owners Receivable for their share of their expenditures for the month and a debit to either Leasehold Cost, Lease and Well Equipment, Intangible Development Costs, or Operating Expense for the operator's share of expenditures and the total of these being a credit to the Joint Venture Clearing Account.

Oil and Gas Sales

As checks are received by the operator, they are restrictively endorsed and forwarded with a two-part deposit slip to the accounting department. The original deposit slip and the checks are deposited daily. The duplicate deposit slip is retained until the bank statement is reconciled. At the end of each month, an entry is made debiting Cash and crediting Oil and Gas Sales Payable for the total amount received.

The accounting department prepares for the service center a monthly production transmittal form on all oil, gas and sulphur sales. Included on this form is the lease number, the production code (oil, gas or sulphur), gross production, compression charges applicable to the lease, production taxes applicable to production, and the net value of production from the lease.

Each royalty and working interest owner is assigned a number which is furnished to the service center along with the owner's division of interest in each lease or unit of production. The service center calculates the amount due each royalty and working interest owner and prepares the checks. The total of these checks is used to make a standard journal entry debiting Oil and Gas Sales Payable and crediting Cash. The operator's portion of the production is handled by a monthly journal entry debiting Oil and Gas Sales Payable and crediting Oil and Gas Income.

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Introducing the New Editor

Miss Mary F. Hall, CPA, of Cincinnati, Ohio, will become editor of THE WOMAN CPA beginning with the December 1967 issue. AWSCPA and ASWA are indeed fortunate that Miss Hall has agreed to take on the many responsibilities of editing their official publication as she has been an outstanding leader in both societies.

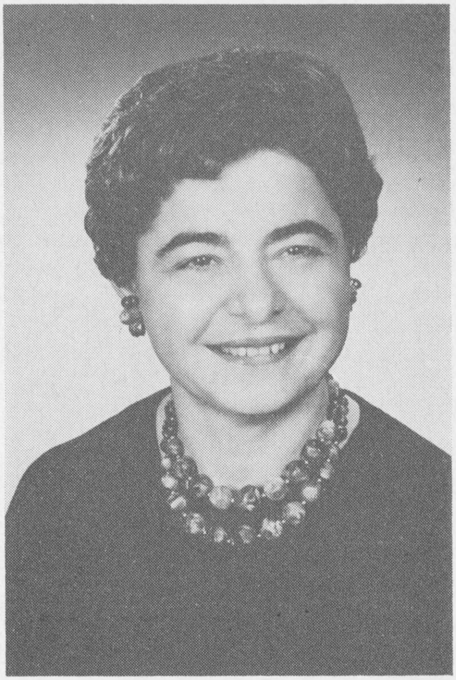
Mary Hall lived in Washington, D. C., for a number of years where she received a Master of Commercial Science degree from Benjamin Franklin University and took additional courses in economics and writing at the American University. She received her CPA certificate from the District of Columbia and holds reciprocal certificates from Massachusetts and Ohio.

Her career includes two and one-half years with the Women's Army Corps during World War II, involving duty in Australia, New Guinea and the Philippine Islands with the 441st Counter Intelligence Corps. She also worked for the Navy Department in Washington for five years before embarking on a public accounting career.

After serving on the staffs of public accounting firms in Washington, D. C. and Boston, Massachusetts, she established her own public accounting practice in Cincinnati three years ago.

Miss Hall served as President of AWSCPA during the 1962-1963 year and as National Secretary of ASWA in the 1957-1958 year. She has also been President of the District of Columbia Chapter of ASWA and is now a member of Cincinnati Chapter. During the past two years she has been Associate Editor of THE WOMAN CPA and Editor of "Tips for Busy Readers."

Miss Hall maintains memberships in the American Institute of Certified Public Accountants, the Ohio, Massachusetts and District of Columbia Societies of CPAs, the National Association of Accountants and the American Accounting Association. She is also a member of the Soroptimist Club and the Business & Professional Women's Club.



It is with the utmost confidence that we relinquish the position of editor to our good friend and respected associate, Mary Hall. We know that the magazine will move ahead successfully under her capable editorship.

To all the editorial staff, the editorial board, the business manager, the various authors and contributors who have made possible the past twelve issues, we extend our most sincere gratitude. In retiring from any position, one always has regrets for ideas and hopes not realized, but there is much satisfaction in having served as the one who put together the writings of members of ASWA and AWSCPA to produce a professional periodical which is truly a product of the two societies. It has been an enriching and rewarding experience to serve as editor.

We look forward with you to the forthcoming issues under the new editor, Mary Hall.

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Another journal entry is required to account for compression income for the operator—a debit to Oil and Gas Sales Payable and a credit to Compression Income. Also it is necessary to account for production taxes with a debit to Oil and Gas Sales Payable and a credit to Production Taxes Payable.

Conclusions

Many of the fine points or details involved in adapting or using a computer service center in the accounting procedure for joint venture operations may not have been covered in this article. It is hoped, however, that the material presented will show how useful this type of operation can be to the small independent operator who engages in a large number of joint operations.