



May 2, 2013

OIL SANDS INFORMATION BULLETIN 2013-11

Subject: Clarification of Arm's Length Costs Incurred and Costs Accrued Under the Generic Royalty Regime

This Information Bulletin replaces [Information Bulletin 2012-11](#) and clarifies when costs are considered "payable" and "incurred" under the *Oil Sands Royalty Regulation, 1997* and the *Oil Sands Royalty Regulation, 2009*.

Costs are an important component of the oil sands generic royalty system. For post-payout Projects, allowed costs incurred in a Period enter into the determination of Net Revenue on which Project royalty is based. For pre-payout Projects, allowed costs incurred in a month enter into the Project's cumulative balance, and earn a return allowance, which is an allowed cost in the next month. Finally, costs incurred prior to a Project's effective date are a major component of a Project's Prior Net Cumulative Balance – which establishes the Project's opening cumulative balance. Although pre-payout costs do not immediately affect royalty payable, by affecting the Project's cumulative balance they affect the date the Project reaches payout and total royalty payable over the Project's life.

The generic royalty regime provides the return allowance on a Project's cumulative balance to reflect the "price" or cost of the funds the Project owners have invested in the Project. Until the funds are actually committed to the Project, they have no cost, and therefore should not earn a return allowance. It is important that allowed costs of an oil sands Project enter the royalty calculation at the correct time, as well as in the correct amount.

The [Oil Sands Royalty Regulation, 2009](#) defines when allowed costs are "incurred", and enter into royalty calculation: in general,

18 (1) For the purposes of this Regulation, an allowed cost

(a) is, in the case of a cost that becomes payable on or after January 1, 2009, deemed to be incurred

(i) in the month in which the cost is payable, to the extent of the amount of the cost that is paid within 90 days after the cost becomes payable, or

(ii) in the month in which the cost is paid, to the extent of the amount of the cost that is paid more than 90 days after the cost becomes payable.

An arm's length cost becomes "payable" only when the true cost liability is known, that is, both the amount of the cost and the date it is due. Receipt of an invoice will likely satisfy these requirements. Delays in receiving an invoice (through the mail, internal accounts payable processing procedures or otherwise) do not impact when that cost is "payable".

In some accounting systems, a cost may be "accrued" as a liability on the receipt of a completed work order, or packing slip, but prior to the receipt of an invoice specifying the final amount due and the prescribed due date. Under the generic oil sands regime, if an item is purchased in, say, January and an estimated cost accrued, and the actual invoice setting out the final cost and terms of payment is dated, say, in February the estimated accrued cost is not an allowed cost of the Project in January. The cost only becomes payable in February and is not considered to be incurred until then, assuming it will be paid within the specified 90 day period.

As a further example, if an invoice is dated January 15, 2013, specifying the cost amount of \$100 and February 28, 2013 as the due date, that cost is "payable" and "incurred" in January. To the extent it is paid within 90 days of the date of the invoice, it is an allowed cost of the Project in January. If \$80 of the cost were paid on February 28, 2013 and \$20 on May 1, 2013, then \$80 would be an allowed cost of the Project in January and \$20 an allowed cost in May.

Once the invoice has been issued by the vendor, the specific details of the transaction - the amount, when the balance is "payable", and any other terms and conditions - will be known. Under the *Oil Sands Royalty Regulation, 2009*, the cost is deemed to be incurred in the month in which the cost is "payable", to the extent that it is paid within 90 days after becoming payable, regardless of the vendor's payment terms. But if an amount is reported as "payable" and is not paid within 90 days, the royalty reports will need to be amended and the amount included in the month in which it was actually paid.

For an arm's length cost which became payable prior to 2009, the provisions of the [Oil Sands Royalty Regulation, 1997](#) determine when the cost is incurred for royalty purposes. Here the period allowed for payment is longer; however, the same rules stated above apply for accruals:

7(2) For the purposes of this Regulation, a cost described in subsection (1) that becomes payable on or before December 31, 2008 is deemed to be incurred

(a) in the month in which the cost is payable, if

(i) the month occurs during a pre-payout Period and the cost is paid not more than 12 months after the end of that month, or

(ii) the month occurs during a post-payout Period and the cost is paid before the end of the calendar year following the Period,

or

(b) in the month in which the cost is paid, in any other case.

Project operators need to ensure that only arm's length costs actually "incurred" in a month are classified as allowed costs of the Project in that month. Cost accruals based on estimates are not "payable" or "incurred" according to the *Oil Sands Royalty Regulation, 1997* and the *Oil Sands Royalty Regulation, 2009*, and are not allowed costs of a royalty Project.

Questions regarding this Information Bulletin may be directed to:

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