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These Procedures set out what is generally regarded in the Industry as good practice. They are not mandatory and operators may adopt different standards in a particular situation where to do so would maintain an equivalent level of reporting.

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NB: All references to “days” in this document refer to calendar days

1 Management Summary

This is the report of the workgroup sponsored by the Finance Directors' Forum (FDF) to review the simplification of UK oil and gas joint venture accounting. The group has concluded that there are numerous areas where, with comparatively little effort, substantial efficiency gains and quality enhancements could be obtained by simplifying current practices. There was a general consensus that existing joint venture accounting procedures are unnecessarily bureaucratic and burdensome. A fundamental review of existing practices, which have evolved slowly since the 1960's, is timely. Procedures should be changed to take account of advances in systems, the evolving roles and needs of both operator and non-operator and increasing levels of mutual trust. It is worth noting that there were no fundamental disagreements among the workgroup on the acceptability of the recommendations made. While some would go further and/or more rapidly, there was a broad consensus on the proposals.

1.1 The recommendations centre on establishing best practice procedures for:

i **Clearer, more consistent joint venture budgets:**

- outline work programme with guideline costings to partners by end July;
- detailed budget issued by the end of September, to be approved by the end of November;
- consistent format between operators;
- a two year outlook beyond the budget year is encouraged for effective planning.

ii **Fewer, better quality AFEs:**

- no AFEs for licence fees, G&A costs (exploration);
- single AFE for construction & HUC projects and development drilling programmes;
- no AFEs for annual operating expense (unless specifically agreed for workovers, based on defined limits);
- fewer AFEs for production capital expense, based on defined limits.

iii **Cash Calls replaced by invoices:**

- an invoice, in sterling only, to replace cash calls, 10 days after period end;
- frequency of invoice submission to be determined by the phase of the operations.

iv **Streamlined billing statements:**

- issued 10 days after relevant period end, along with funding invoice, in sterling only;
- standardised format, at least at summary level; and
- no reconciliation to cash called required if (iii) above is implemented.

v **Better quality management information:**

- monthly for development projects, quarterly for all other fields, and ad hoc for E&A to coincide with activity, in sterling only;
- consistent with budget classifications.

vi **Standard documents:**

- budgets, billing statements, AFEs and management information documents to be based on pro forma layouts.

1.2 These practices will achieve savings in the effort required to carry out joint venture accounting tasks, allowing it to be concentrated on adding value to the business. However, the changes can only come about if the culture of joint venture management also continues to change, allowing greater trust and openness among co-venturers. There is a responsibility on operators and non-operators alike to promote this.

1.3 As to the way forward for this project, the following steps are considered necessary:

i review, comment and endorsement by the FDF;

ii exposure to the wider industry for comment, revision and further approval as required, followed by endorsement and issue by UKOOA;

iii adoption, by individual companies, as soon as practicable via the relevant co-venturer meetings;

iv periodic subsequent review of implementation – perhaps a task that can best be delegated to the Oil Industry Finance Association (OIFA) and on which joint venture auditors can comment.

1.4 A key issue for further consideration concerns how to handle potential conflicts with the requirements of existing JOAs. There are likely to be numerous such conflicts, making JOA amendment unlikely to be practicable. An approach involving partner agreement to the principles in the first instance, followed by a formal “side letter” may prove the most profitable, however, this is an onerous task. It is therefore recommended to adopt these procedures as issued by UKOOA as industry best practice without formally amending agreements unless specifically requested to do so.

2 Introduction

The FDF of UK operators has sponsored a series of initiatives to undertake a business process review within the accounting functions of the UK upstream oil and gas industry. The first areas to be tackled were Joint Venture Accounting Simplification, Overhead Recovery, Joint Venture Audit and "radical options". These procedures cover the Joint Venture Accounting Simplification project, where there is perceived to be considerable scope for efficiencies through reducing duplication, eliminating unnecessary reporting and standardising certain procedures. Equally important, there are opportunities to add value by re-focusing the substantial efforts expended in these areas towards quality budgeting and reporting of commercially-relevant matters.

These procedures have been proposed by a workgroup comprising representatives from eight companies, working in consultation with the FDF and the Oil Industry Finance Association (OIFA). They are intended to document agreed practice in these areas, centering on the UK. The group comprised:

Co-ordinators

R McKinnon	:	Enterprise
C Pilbeam	:	Enterprise
S McCarthy	:	Shell
K Forrest	:	Shell
A Bell	:	Monument
J Clouting	:	Amerada Hess
B Duncan	:	Elf/Amerada Hess
A Holding	:	Ranger
D Hunter	:	BP
P Manktelow	:	Amoco
L Morgan	:	Mobil
N Smith	:	Accenture

The work group's process has involved numerous meetings and workshops as well as a wider canvassing of views through OIFA.

The Terms of Reference for the workgroup were:

i Objectives

Through simplification and standardisation of financial data exchange and related approval processes, enhance the quality and comparability of financial information, for operators and non-operators alike and achieve savings in administration costs.

ii Deliverables

To produce a set of procedures, agreed by the FDF, outlining best practice, preferred content and common presentation of joint venture financial documents, and the standardisation of approval and timing requirements for expenditures.

iii Scope

- Billing statement/invoice support;
- Venture budgeting procedures;
- Management reports;
- Funding arrangements;
- AFE requirement, content and support.

3 Budgets

3.1 Purpose

The Joint Venture Budget is partly a forward plan for the venture - this is useful early in the annual cycle as each co-venturer begins its own planning, resource allocation and budgeting process. It offers an early opportunity for co-venturers to react to the direction of the underlying work programme. It is also the basis for approval of all expenditure that does not require an AFE, and the foundation for subsequent cost control and performance reporting.

3.2 Concerns with Current Practice

Problems with the annual joint venture budget cycle include:

- timing of issue and approval (each co-venturer seems to work to a different internal timetable);
- the period covered by the budget – typically only the following calendar year, whereas operators may need to make commitments for later periods;
- no consistency of format or level of detail, between operators or with subsequent reporting;
- confusion over what approval has been formally sought and achieved in respect of “contingent” items.

These concerns can lead to the late approval of budgets, inhibiting optimum commitment to expenditure.

3.3 Proposals

3.3.1 Timing

Budgets should normally be issued once annually, with the exception of the initiation of a development project budget, which may depend on factors (e.g. government approval of the development plan) that do not coincide with an annual cycle.

An outline work-programme with preliminary costings should be issued by the operator by the end of July for the following year; this is not for formal approval, but to facilitate the planning process of companies involved in a number of ventures. Technical / Finance sub-committees should play a major role in this process.

A more detailed formal budget proposal should be issued slightly later than occurs in some instances at present. This will allow the budget to have a firmer basis and reduce, though not eliminate, the number of contingent items. This should be issued by the end of September with approval sought by the end of November.

3.3.2 **Content and Format**

The information required to support the budget proposal varies according to the phase of activity and type of expenditure. Materiality is the main criterion for the level of explanation required. It is acknowledged that some of this information may be communicated at the relevant co-venturers' meeting. Materiality depends both upon size and nature - non-recurring or unusual items are worthy of more explanation.

Budget presentation should be consistent in the categories of activity and expenditure at each phase of the business cycle - recommended headings are set out in Attachments 1 and 2. These categories should also form the basis of the billing statement and management reports (sections 5 and 7).

"Contingent" items should be clearly identified to avoid confusion as to what approval is being sought. Contingent items would need subsequent approval.

The following information is recommended:

- work programme and assumptions, including production details (if applicable);
- phased expenditure, by quarter, by major classification or anticipated AFE for the budget year;
- a forecast outlook at summary level for the current year plus the two years beyond the budget year.

An update of the current year forecast helps to justify the new budget.

3.3.3 **Approvals**

Budget approval will not always be the final approval required before the operator can commit to expenditure (see section 4). Approvals depend on the phase of the business cycle being budgeted:

a **Exploration and Appraisal (E&A)**

For care and maintenance activities, details of licence rentals and minimum overhead costs should be advised and deemed as approved, unless objections are raised within 60 days of issue.

Active licences, including all wells and major G&G projects, require AFE approval. Other costs, e.g. minor studies, licence rentals and overheads should be approved at the budget stage.

b **Developments**

An initial budget for total expenditure over the life of the project will be approved, and subject to annual review in the subsequent years' budgets. Transfers between budget categories are permitted up to a maximum of 10%, and will be reported in Management Information unless the total budget moves by more than the allowed (10%) tolerance, when formal approval is required.

c **Producing Fields: Operating Expense (Opex)**

Operating expense should be approved by category at the budget stage i.e. no AFEs should be required (see section 4). For contracted volume based tariffs, there is no need to approve revised budgets for increased (or decreased) production.

d **Producing Fields: Capital Expenditure (Capex)**

An appropriate level of budget funds for minor works should be agreed by year by joint venture. This will be utilised at the operator's discretion. Work performed will be advised through technical committees, billings and/or separate management information reports. All other projects (including drilling) >£500,000 should require AFE approval (see section 4).

3.5 All budgets should be expressed in sterling, but with co-ventures given the option of having major currency commitments shown separately.

4 Authorisation for Expenditure (AFE)

4.1 Purpose

AFEs are a formal communication between co-ventures to confirm technical and financial approval for a specific piece of work, and is a control mechanism for subsequent reporting.

4.2 Concerns with Current Practice

The process frequently adds little value in too many cases. Both the number and timing of AFEs are issues: there are generally too many, issued too late; "Deemed approval" always attracts heated debate when negotiating Accounting Procedures, as does the issue of AFEs for unbudgeted items. It is also felt that AFEs need too many signatures and are time-consuming to track and process.

4.3 Proposals

4.3.1 Exploration & Appraisal

No AFE should be raised for licence fees or internal G&A costs; items not the subject of an AFE must be approved at budget level. An AFE will be required for G&G activity where individual workscopes exceed £100,000.

One AFE per well should be raised for drilling (i.e. to cover site survey, long lead items, dry hole plus testing) activity, when the operator is estimating with confidence. A combined AFE is not practicable when the scope of testing is not defined up front. Funds would be released (by faxed approval) at each stage of the well, with no transfers of funds between categories allowed. AFE supplements and short term approvals, inevitably required on occasion due to unforeseen difficulties, should be processed in a pragmatic way by fax.

4.3.2 Development Phase

A single AFE should be approved for construction costs (including HUC), with a number of sub-categories, consistent with the budget. Transfers will be permitted between these headings up to a 10% tolerance limit (see section 3). Technical approval will still be sought for major design changes. If the prime scope changes significantly, the AFE should be resubmitted by the operator for co-venturer approval.

A single AFE should cover the financial approval of a development drilling programme, or on an annual basis where the programme covers more than one financial year, although technical approval is still required for each well (via Technical Committee, or equivalent). Cost control and reporting will be on a well by well basis.

4.3.3 **Production Phase**

No AFE should be required for annual operating expenditure, unless specifically agreed by co-venturers for well workovers where the anticipated final cost exceeds £500,000. Infill drilling (programme by programme), and other major capital projects over £500,000, should be subject to separate AFE approval.

4.4 **Approval**

AFEs for >£5 million (gross) should be deemed approved 30 days from issue if no response is received from the relevant co-venturer, unless varied by common agreement. Any query or request for more information from a co-venturer in this period will mean the AFE remains unapproved until the query is answered or the pass mark is reached; the AFE would be deemed approved by the co-venturer 30 days from the operator's response if no further communication is received from the co-venturer. The operator will issue a reminder 10 days from the due date if the pass mark has not been reached.

4.5 **Items not AFE'd**

Such items are subject to approval in the budget process.

4.6 **AFE Supplements**

These will be handled according to the terms of individual Accounting Procedures attached to Joint Operating Agreements (JOAs). The operator will issue a revised estimate as soon as reasonably practicable to allow technical approval of the work to continue, with the full AFE Supplement document provided at the end of the operation.

5 Billing Statements

5.1 Purpose

Billing Statements provide details of net expenditure incurred (i.e. including receipts) by the operator on behalf of the joint venture. This allows co-venturers to fulfill their own financial reporting, legal and fiscal obligations to maintain accounting records. They may provide a formal invoice for VAT purposes.

Billing statements should not be regarded as a source of Management Information, which should be provided separately (see section 7).

5.2 Concerns with Current Practice

Current billing statements lack consistency in style, format, content and level of detail, making understanding and booking difficult. Billing statements therefore generate substantial low-value work. In addition, they often present classifications which are inconsistent with Management Information.

5.3 Proposals

5.3.1 Frequency and Timing

Billing Statements should be issued to coincide with the issue of the funding invoice (see section 6). Generally this will be monthly, with the exception of care and maintenance expenditure during exploration phases, which should be issued on bi-annual basis (one issued after payment of licence fee, the second issued after the end of the calendar year).

Billing Statements will be issued no later than ten days after the end of the appropriate accounting period, with the precise date determined by the operator's internal accounting timetable.

5.3.2 Format/Content

Format and content should be consistent with the Management Information and Budget classifications, but at a summarised level of detail, recognising the purpose outlined above.

Billing statements will provide details of gross expenditure and receipts on joint operations, by licence, for the current period and the year-to-date, by major budget classifications (see Attachment 3). Inception-to-date balances will be provided for all AFEs active during the current accounting year and working capital (see Attachment 4). It is recognised that these templates may need to be modified to meet specific venture circumstances.

The operator will provide details of tangible/intangible well expenditure as requested in an ad hoc basis.

Cash reconciliations will no longer be required within Billing Statements once cash calling is discontinued (see section 6).

5.3.3 **Currency**

All expenditure incurred or amounts received by the operator, regardless of currency, should routinely be charged to the joint account in sterling. All Billing Statements should be in sterling only. The only exceptions are where expenditures against major foreign currency denominated contracts have previously been agreed between co-venturers.

6 Funding Arrangements

6.1 Purpose

To enable operators to make payments on behalf of the Joint Venture so that no significant gain or loss arises to the operator.

6.2 Concerns with Current Practice

Cash calling is generally labour intensive, inefficient and involves uncertainty and estimation, due to the management and reconciliation of the numerous bank accounts involved, multi-currency funding arrangements, reconciliation to expenditure and forecasting of cash commitments.

6.3 Proposals

Cash advances should be replaced, as soon as practicable, by invoice funding in arrears for all venturers, in all phases.

The amount to be invoiced should be the net cash outlay for the venture for the period, i.e. excluding accruals except where such accruals are inconsequential and difficult to identify, for example because charges result from complex apportionments of cost pools.

6.3.1 Frequency and Timing

Invoices should be issued monthly, except for care and maintenance expenditure during Exploration, which should be issued on bi-annual basis (one issued the month after payment of licence fee the second issued after the end of the calendar year).

The invoice will be issued by fax and letter no later than ten days after the end of the appropriate accounting period and itemised in the billing statement (see section 5).

The invoice should be payable ten days following the date of issue. The payment date should be clearly stated on the invoice. Queries should be raised with the operator as soon as practical but this must not affect the payment of the invoice.

Any disputed amounts should be brought to the attention of the operator and credit requested. If the query cannot be resolved, the amount under query will be deducted from the following invoice.

6.3.2 Operator's Cost of Finance

In consideration of the operator funding the costs of the joint operation in advance, a fee should be chargeable by the operator to each co-venturer on the basis of the following formula:

$$F = (C \times PI) \times I \times P/A$$

Where:

F	represents the fee payable by the relevant co-venturer to the operator;
C	represents the cash cost of joint operations funded by the operator on behalf of the co-venturers and invoiced by the operator to the co-venturers;
PI	represents the percentage interest of the relevant co-venturer under the JOA;
A	represents the number of days in a year.
P	represents the number of days from the midpoint date of the relevant processing month to the due date of settlement of the relevant invoice;
I	represents one month LIBOR as quoted in the Financial Times. The rate used will be the rate prevailing on the first day of the appropriate credit period which will fall 15 days prior to the end of the operator's accounting month. This will result in a maximum credit period of 35 days made up as follows:

Start of Credit Period to Operator's Month End	15 days
Issue of Invoice after Operator's Month End	10 days
Payment of Invoice to Operator	10 days
Total Credit Period	35 days

If the operator's accounting system has the functionality to allow interest to be calculated on a daily basis, this is an option that can be pursued.

NB: In the case of care and maintenance invoices for exploration activity, expenditure should be treated as being incurred in the month preceding the invoice and will be treated as above.

6.3.4 Format/Content

The invoice and billing statement will be issued together, and will show the total amount payable by each co-venturer, i.e. cash expenditure for the relevant period and the financing fee, shown separately. Specific details of cash expenditure for the relevant period can be shown on the invoice or the billing statement.

6.3.5 Currency

Invoices will be issued and payable in sterling only unless otherwise agreed for specific contractual expenditure (see section 5).

6.3.6 **Default**

Existing default arrangements which apply to non-payment of cash calls should continue to apply in relation to the non-payment of invoices.

6.4 **Audit**

If requested by co-venturers, operators should arrange for their statutory auditor or a suitably qualified independent accountant to provide comfort on the average timing of cash movements. The results of this audit will be made available to the co-venturers, and the cost of the audit shared on an equitable basis.

7 Management Information

7.1 Purpose

Management Information provides the information to enable co-venturers to review performance against budget, AFEs and other targets and to meet their internal forecasting requirements.

7.2 Concerns with Current Practice

A limited number of operators issue regular management reports. There is no consistency in format or content, making interpretation and analysis difficult. Figures are often inconsistent with budgets and billing statements, which have often been used as poor substitutes for management information.

7.3 Proposals

The issue of management information should be encouraged.

7.3.1 Frequency & Timing

Management information should be issued monthly for development projects and quarterly for producing fields. Seismic, G&G and E&A drilling reports should be issued on an ad hoc basis. Licences in a care and maintenance phase only do not require additional management information.

Information should be issued no later than twenty days after the end of the period to which they relate.

7.3.2 Format/Content

Reporting classifications used should be consistent with budget and billing statement classifications (including inception-to-date balances where appropriate, e.g. AFEs). However, management information will normally be prepared to a more detailed level than billing statements, to enable co-venturers to perform their own analysis. The emphasis should be placed on looking forward rather than back; appropriate variance analysis and narrative should be provided.

Specific recommendations are shown in Attachments 5 & 6, although these may need to be modified to meet specific venture circumstances.

7.3.3 Currency

All figures quoted in management reports should be sterling only, and reported in thousands of pounds.

Appendices

1 Budgets – Form and Content

2 Budgets – Pro Forma

3 Billing Statement – Form and Content

4 Billing Statement – Pro Forma

5 Management Information – Form and Content – Development Phase

6 Management Information – Form and Content – Production Phase

7 Glossary

Attachment 1

Budget Document – Format & Content

	Level of Detail
Exploration & Appraisal:	
▪ Drilling & Testing	Wells Individually by prospect
▪ Seismic G&G	Minor studies and specific projects itemised
▪ Licence Fees	Area x rate
▪ Tech. & Admin. (*) supported by Time/Effort/Rate	In-house, Direct & Overhead Charges
▪ Pre Development Work	
Developments:	
▪ Construction	By project, supported by BSI
▪ Drilling	Number of wells, phasing of costs. Rig.
Production:	
▪ Tariff & Transportation	By product
▪ Annual Operating Exp/Receipts (**)	Not netted off, 2 separate lines
▪ Drilling Capex	Same as developments, drilling
▪ Facilities Capex	Major projects, minor works pot
Total Gross Expenditure	

(*) could be included in surveys or wells above.

(**) Annual operating expenditure by major element/process typically:

- Production
- Maintenance
- Underwater
- Topsides
- Engineering.

Attachment 2

Budget Document – Pro Forma

	Q1	Q2	Q3	Q4	Total	1999	2000	2001	2002
Exploration & Appraisal: ▪ Firm Items ▪ Contingent Items									
Development: ▪ Firm Items ▪ Contingency									
Production: ▪ Firm Items ▪ Contingent Items									

Attachment 3

Billing Statement – Format & Content

	Current Month	Year to Date
Exploration & Appraisal:		
▪ Drilling & Testing ▪ Seismic G&G ▪ Licence Fees ▪ Tech. & Admin ▪ Pre Development Work	XXX	XXX
Developments:		
▪ Construction ▪ Drilling	XXX	XXX
Production:		
▪ Tariff & Transportation ▪ Annual Operating Exp./Receipts ▪ Drilling Capex ▪ Facilities Capex	XXX	XXX
Total Gross Expenditure	**XXX**	**XXX**
Working Capital:		
▪ Stock ▪ Accruals ▪ Other	XXX	XXX
Total Cash Expenditure	**XXX**	**XXX**

Attachment 4

Billing Statement – AFE Report – Format & Content
Exploration & Appraisal

	Current Month	Year to Date	Inception to Date
Drilling & Testing: ▪ AFE 123 – Well – A01 ▪ AFE 456 – Well – A02 ▪ AFE 789 – Well – A03			
Total Drilling & Testing	**XXX**	**XXX**	**XXX**

NB: Typically this type of report will be produced for all expenditure controlled by AFE.

Attachment 5

Management Information – Format & Content
Development Phase

	Project Budget & AFE Value	Inception to Date Expenditure	Estimate to Complete	Anticipated Final Costs	Variance from Project Budget and AFC
Construction:					
▪ Sub Classifications per budget					
Drilling					
▪ Sub Classifications per budget					
Total Expenditure					

Notes:

a Supplementary information will be provided on a Project by Project basis as required.

b All figures quoted above are in £000's.

c Commentary to be provided on all significant variances.

d Phasing of Expenditure to end of the Budget period will be provided at major classification level by quarter.

e Residual Development Capex after first oil will be incorporated into the Production Phase reports.

Attachment 6

Management Information – Format & Content
Production Phase

	Year to Date Actuals	Previous Full Year Forecast	Last Full Year Forecast	Variance from Previous Forecast	Approved Annual Budget
Annual Operating Exp./Receipts: ▪ Sub Classifications per budget **Tariffs & Transportation:** ▪ Sub Classifications per budget **Capex:** ▪ Drilling by AFE ▪ Facilities (Major) by AFE ▪ Other Capex **Total Expenditure**					

Notes:

a All figures quoted above are in £000's.

b Commentary to be provided on all significant variances.

c Phasing of Expenditure to end of the Budget period will be provided at major classification level by quarter.

d In addition a further report will be provided for all ATE type expenditure showing AFE Value, Inception to Date Costs and Anticipated Final Cost.

Attachment 7

Glossary

AFE	Authorisation for Expenditure
Capex	Capital Expenditure
E&A	Exploration & Appraisal
FDF	Finance Directors' Forum
G&A	General & Admin
G&G	Geological & Geophysical
HUC	Hook Up and Commissioning
JOA	Joint Operating Agreement
OIFA	Oil Industry Finance Association
Opex	Operating Expenditure
SOAP	Standard Oil Industry Accounting Procedures
UKOOA	UK Offshore Operators Association Limited
VAT	Value Added Tax