



**Standard Oil Accounting Procedures
Materials Accounting**

**SOAP 5
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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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1 Objective

The objective of this Accounting Procedure is to require UK Upstream Oil Companies to account for materials and inventory on a 'fit for purpose' basis rather than utilising condition codes. This Procedure is also intended to describe and encapsulate current best practice in Accounting for Materials.

2 Explanation

- i The majority of existing Joint Operating Agreements and Unit Agreements state that material transferred to joint operations accounts from operators or any of their affiliates is valued on the basis of condition codes. New Material is valued on a Condition 'A' basis (lower of cost or current market value) and used material takes a continuum of Codes B to E (75% value to nil) based on its condition. This has been found to be cumbersome to operate, inconsistent, open to subjective interpretation and difficult to standardise.
- ii In the era of the UKOOA's 'CRINE' initiative, with the commensurate requirement to reduce cost and improve operating efficiencies, many Operators have introduced alternative methods of accounting for inventory which meet this need.
- iii The Operator has an obligation, under good oil and gas field practice, to ensure the safe custody of materials. The Operator shall periodically advise all Parties of its programme of physical stock takes. Parties shall have the right, upon giving prior written notice to the Operator, to attend one or more physical stock takes and to review the associated verification, and any resulting adjustment, of the accounting records of the stock so counted.

3 Accounting Procedure

- i Material purchased and supplied by Operators or their affiliates which is intended to be used on the joint operations should be 'fit for the purpose'.
- ii Material which is 'fit for purpose' should be accounted for at the moving average value for the particular item of inventory.
- iii New material purchased from third parties should continue to be valued at cost, which shall mean net invoice price (after deducting all trade and cash discounts actually received), together with transport costs, forwarding and documentation fees, packing costs, duties, licence fees, non recoverable taxes and like items chargeable. This cost will affect the moving average value for the respective items of inventory.
- iv Material which is **not** 'fit for purpose' is deemed to be scrap and should be carried at nil value.

- v The same criteria applies to returned materials:
- Material which remains 'fit for purpose' after use should be returned to inventory at moving average value;
 - Material which, after inspection, is deemed **not** to be 'fit for purpose' should be accounted for at nil (scrap) value;
 - Material which is subject to inspection and repair should be returned to inventory at moving average value **after** repair;
 - Cost of inspection and repair to be borne by the user licence.
- vi Bulk materials left on drilling rigs at the time of transfer of user should be valued at the cost to the initial purchaser. In certain circumstances, having regard to the commerciality of the transaction and where it is agreed by the parties, current market values may be substituted for cost to the initial purchaser. The same rules apply, as noted above, for bulk materials deemed to be **not** 'fit for purpose'.
- vii Transfers of inventory between licences should be made at the moving average value (**except** in exceptional instances as noted below) as it is 'fit for the purpose'.
- Market values may be substituted for moving average value where, having regard to the commerciality of the transaction:
 - it is agreed by the parties;
 - use of moving average value will be disadvantageous to the parties.
 - For rockbits, special rules may apply. The purchase cost of the rockbit may be applied to the initial user licence. If the rockbit is used subsequently on another licence, it may be transferred at nil value, but the cost of refurbishment will be borne by the next user licence.
 - Rockbits may also be accounted for on a 'two user' basis, whereby the initial user bears 100% of the cost, and obtains 50% credit upon transfer to the second user. Thenceforth the same rules as given in (vii) bullet point 2 above apply.
- viii Insurance Spares will be carried by Operators to meet emergency needs. These items of inventory are deemed to be critical and special rules apply in their accounting treatment:
- Insurance Spares should be capitalised at their original value and treated as fixed assets;
 - Insurance Spares which are carried as assets should be recorded in the stock system at peppercorn values.

- ix Provisions for obsolescence and disposal may be applied to slow moving inventory. 'Slow moving' may be defined as inventory with a nil turnover over 24 months. Note: This does **not** apply to Insurance Spares – see paragraph (viii) above.
- x In some cases Operators maintain a system of Common Field Inventories ie inventory which may be applied to all or several licences. Transfers from such common inventories will attract a financing charge, such charge reflecting the cost to Operators of maintaining the inventory. The consequent value of inventory may be computed using a formula which contains all or some of the following components:
- Moving average value (values amended for each addition of stock);
 - Financing charge, usually equal to a percentage rate above LIBOR (percentage rate to be agreed as part of the financial parameters in the Accounting Procedure);
 - Stock Turnover. Amount of stock used in any period, normally one year. This turnover will be restricted to specific or groupings of inventory, to eliminate the skewing effect of slow moving/damaged/obsolete materials.

Surplus inventory returned to Common Field stocks shall generate a financing credit calculated as set out above.

It may be noted that instances of application of this paragraph may be very limited as costs of maintaining large inventories are prohibitive and thus operating procedures should discourage and preclude companies from building such volumes of inventory.

- xi Inventories may be maintained at third parties; in which case the following rules apply:
- Stocks held at third parties, to which Operators have **ownership**, should be included within the overall value of the respective inventory;
 - The **same** valuation rules apply as heretofore stated;
 - Proper controls over inventory movements to/from third party stockists should be maintained, with appropriate audit trails for all stock values and returns;
 - Third parties should report monthly to Operators, opening and closing balances, together with issues and returns of material.
- xii It is recommended that Operators introduce a system under which inventory held at third parties is subject to periodic review and inspection. Regularity of review will be made having regard to the respective values of the inventories concerned.
- xiii The value limits (individual and aggregate) under which partner approval for disposal of inventory is required are set in Paragraph 4 (6) of the Accounting Procedure.



- xiv Inventory that is surplus at the completion of a capital project should be transferred into the Operator's standard stock at the 'fit for purpose' value. The transfer should be made commensurate with the time the project becomes live and operating costs are incurred. The relevant credit should be made to the original project.

4 **Application**

This procedure sets out what is generally considered to be best industry practice. In the event that any particular Operator departs from this procedure, it is recommended that such exceptions are appropriately notified the respective non-operating parties.