

Key tips for using SAP® to improve Joint Venture Cost Recovery



Exploration and production companies are under increasing pressure to recover costs during complex production sharing agreements and joint venture operations. The ability to effectively allocate and recover costs from non-operating partners in accordance with the terms of Joint Operating Agreements (JOA) and Joint Venture Contracts (JVC) can make a significant difference to the level of corporate cost absorbed by the operator.

SAP has various tools and functions which provide operators with assistance in allocating shared costs in accordance with contractual terms, with a full audit trail possible to meet the requirements of JV audits and also to provide transparent reporting to partners.

With more than 20 years' experience of working with SAP in the oil and gas sector, Absoft can ensure that operators use tools available to them effectively, and can provide guidance on how to replicate a cost recovery process using SAP allocation tools. Absoft has also found that even operators with a well-established SAP finance system can benefit from a periodic review of processes, master data

and methodology to prevent their allocation and recovery processes becoming dated, inefficient and potentially in breach of JOA allowances.

In a recent example, Absoft was able to implement an automated allocation process for a North Sea operator which was able to charge approximately £20m/ NOK 190m additional billable cost to JVs, leading to recovery of more than £11m/ NOK 106m from non-operating partners of approximately 10 operated JVs.

This paper provides top tips for improving JV cost recovery based on Absoft's experiences in this area.



1. Map the required allocation structure on paper

The more discussion that takes place around which costs should be allocated where, the more those discussing the potential solutions can lose sight of 'the possible' as layers of complexity are added, often with conflicting purposes.

It is easy, at a high level, to think about general rules which are applicable to allocations, but in doing this, the business can lose sight of exceptions which exist and which could present problems to true automation. Always test the theory of generalisation by asking questions such as:

- "Is that always the case?"
- "Do all sender cost objects of the same type follow the same principle?"
- "Can the same basis of allocation always be used to generate allowable/ fair results?"

Often, the best way to generate qualifiers such as: "apart from x, where this happens instead", is to group the types of allocating cost objects together and stick boxes on flip charts similar to an organogram. This helps to test theories on the flow of costs to ensure that not only is it possible to break down constituent parts of allocations (overheads, departmental costs, intercompany costs, non-recoverable costs), but that it will be possible to apply automated rules to how and where each part will allocate costs.

Once all the parts have been defined, try to link these into some kind of process flow, to identify the order of each level of allocation.





2. Assess the quality of master data in your SAP system

There are two steps to this process. In step one, having mapped the theoretical structure required on paper, think about how well structured the master data is in SAP to achieve the desired outcome. Map out the key aspects of each step of allocation and consider:

- “Where are the costs to be allocated in this step?” (cost centres, cost elements)
- “On what basis should costs be allocated?” (time, headcount, usage, consumption)
- “Where are the potential receivers of cost?” (cost centres, orders, WBS elements)

Step two is to consider which aspects may validate the above questions:

- “Do any costs which require to be allocated in different ways get booked to the same codes?” If so, you may need additional cost centres
- “Are there naming conventions in place which could easily be used to separate out different types of sender codes?”
- “Do all allocation bases exist in SAP – do you maintain statistical key figures for headcount or usage etc? Are these to be maintained manually, or can you automate the update of this information somehow?”



3. Does a true cascade of costs exist in the allocation structure?

The easiest cost allocation structures work in a straightforward cascade structure – each level of costs allocates down to the next set of senders, which in turn allocates down to another level, and eventually costs are allocated to a set of end receivers.

However, in many cases it is not possible to separate out a structure in this way, and it is necessary for costs to be allocated either upwards in the overall structure, or to be allocated to other senders in the same level of allocation.

These situations will have a bearing on setting up the allocation master data in SAP. It may be possible to set up additional allocation cycles, or to set some cycles as iterative to take account of an ever reducing flow of a share of costs being allocated within the same cycle.



4. Determine the best SAP allocation type for each level of allocation

SAP allows for different types of cost allocation to be made. Each has its advantages and disadvantages, and in most cases, each has its own most common use:

- **Activity allocation:** Most commonly used for allocations where the allocation method is related to consumption of something which has an inherent unit value, such as timewriting. Indeed, in situations where SAP CATS is used for timewriting, an activity allocation can be made automatically on completion or approval of timesheets. In this case, activity types will be maintained with a planned cost, and timewriters will be linked to one such activity, meaning that whenever they write any time to a specific code, it will attract a charge based on the planned cost.
- **Assessment allocation:** Most commonly used for allocation of overheads, assessment allocations aggregate costs across multiple cost elements and allocates the cost based on a specified allocation basis using a secondary cost element defined in the allocation segment.
- **Distribution allocation:** Whereas assessment allocations aggregate costs across multiple cost elements, distribution allocations use the original cost element when allocating costs. This vastly increases the volume of transactional data created by the allocation posting, but can be useful where there is a desire to retain visibility of the origin of the cost, for regulatory or audit compliance reasons for example.



5. Create sets, groups and hierarchies to support the allocation structure

As far as possible, it is always worth trying to define an allocation structure in SAP by grouping sets of master data. Not only does this simplify some of the allocation definition in a segment, but it also helps to structure and maintain the overall knowledge levels of the purpose and design of the allocation structure. Consider using some of the following:

- **Alternative cost centre group:** Where you have multiple levels of allocations with cost centres as senders, set up an allocation hierarchy with separate nodes for each level of allocation.
- **Sets:** Much of the allocation master data within cycles allows for the specification of sets to indicate the profile of sender or receiver data, including WBS elements, orders, cost elements, cost centres and recovery indicators.

Beneath these, it is also worth considering adding an end receiver's node for any costcentres which may receive allocations at the end of the allocation process. This also facilitates the display of Controlling (CO) module reports in the allocation structure.



6. Consider external factors which may reduce effectiveness

In thinking about optimising a cost allocation structure, think about the reasons why any current structure is in need of optimisation. A number of reasons may be prevalent within an existing process, some of which may inhibit the effectiveness of automation. Some examples include:

- **Lack of clarity over allocation levels or organisation structure:** When mapping out the process on paper you discover a large number of exceptions to a level of cost allocation. This may make it difficult to design an allocation structure, or may complicate the execution of allocations due to the number of dependencies and loops of costs being allocated upwards/ horizontal in addition to a cascade.
- **Timewriting discipline:** If part of the allocation process is related to timewriting, a reasonable level of comfort must be gained as to the quality of data gained from timewriting:
 - Is there a sufficient number of people timewriting to establish quality of data? If there are large delays or non-conformers, you may end up with skewed data as a department allocation may end up being based on only one or two individuals.
- Do timewriters use the correct codes? Have you trained those people able to use who be the correct codes for the work they are doing? If people revert to the codes they always use and which work, then a JV audit is likely to reveal time and cost being allocated to projects which completed a number of years ago!
- **Integration of required data into SAP:** If SAP CATS is not your timewriting application, it may be a complex process to map data from your timewriting system into SAP either on an interface basis or via manual upload.
- Allocation bases such as usage, headcount etc will also need to be captured as statistical key figures. Is there a clear responsibility on individual(s) to be able to extract and maintain this information on a timely basis?



7. Actualisation of any planned rates included

Where any activity allocations are used in the allocation process, these are likely to utilise a planned activity rate. This will lead to an over/ under absorption building up in the sender codes, which will need to be actualised at some point. Historically, some areas have only actualised this data two or three times a year (including year-end).

Where this is your desired process, ensure you allow suitable time and resource at these points to have proper validation of the impact of this.

In addition, also ensure that somebody is monitoring the over/ under values on sender codes to ensure that planned rates are not causing too substantial a debit or credit balance to build up.

If all the data is in SAP consider whether it may also be an opportunity to build in an actualisation step into a monthly process, to ensure the allocation built into every month of data being allocated is as accurate as possible. Assessment cycles can easily be built to allocate any over/ under on the basis of all timewriting done.



8. Impact on month-end timetable from allocation requirements

In some cases, there may be some interdependencies created in allocations which impact upon the month-end process, causing some steps to be reordered or run more than once to allow suitable and correct allocation of costs.

As an example, it may be allowable within JOAs to allocate a share of depreciation related to specific corporate fixed assets. However, in most JV-related SAP timetables, depreciation is run towards the end of the month-end process, after cutback, and after cost allocations which impact billable balances.

In this scenario, the month-end process could be re-mapped to have two runs of depreciation, so that depreciation of corporate assets (which are typically depreciated on a straight-line basis) takes place before allocations, and a further depreciation run is conducted as normal at the end of the month-end process after cutback/ settlement of JV additions to unit of production assets.



9. Clear responsibilities for executing and maintaining allocation steps

- If you already use SAP, you may have an allocation structure in place. Is there a clear responsibility placed on individual(s) not only to run allocations at period end, but also on maintaining the master data related to allocations?
- Do all of these individuals have SAP knowledge to ensure that processes are updated and master data such as sets and hierarchies are maintained? If not, updating the process will only work in the short term, as without further training, any updated process will also quickly become out of date.

The points above are some of the key considerations for finance department management in determining an effective cost allocation for E&P companies.

Making good quality decisions about the points covered here can help to streamline processes, and also allow effective allocation of costs within JOAs/ contractual allowances, meaning a greater recovery of costs from non-operating partners.

If the operator of JVs, where you have a non-operated equity, has optimised their allocations for cost recovery, then you are potentially going to be at a disadvantage unless you optimise your own cost recovery process.

Furthermore, many of these tools can effectively be used by non-JV companies who may have similar requirements to recharge project expenditure to third parties based on service provision for example.

About Absoft

Absoft is the leading provider of SAP solutions and services to the upstream oil and gas industry in the North Sea. With over 20 years' experience in delivering SAP solutions tailored to the needs of the sector and implementations in over 40 countries, Absoft has unrivalled knowledge of global upstream oil and gas business processes.

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