



# COST CLASSIFICATION IN OIL AND GAS INDUSTRY

**Dr. Armayau Alhaji Sani**

**Course : Oil and Gas  
Accounting**

**Course Code: ACC 404**

# Learning Objective

In this section, students are expected to learn the following:

1. Royalty Cost, Drilling Cost, Acquisition Costs
2. Development Cost
3. Exploration and Appraisal Costs
4. Production Costs
5. Supporting Facilities and Equipment Costs
6. Tangible and Intangible Costs

# Cost Classification in Oil and Gas Sector



## Acquisition Costs:

These are incurred to purchase, lease or otherwise acquire a property (whether proved or unproved). Example includes the cost of signature or lease bonuses, options to purchase or lease properties, brokerage, legal fees.

## Example 1- Acquisition Cost

Sabrin and Shayma Ltd acquired a 620 acre unproved property. The company paid a lease bonus of \$250/acre and recording fees of \$100,000. The company also incurred legal fee amounting to \$30,000 and a signature bonus of 30% of total cost before signature bonus.

Required : Calculate the total acquisition cost and state the journal entry.



## Example 2- Acquisition Cost

Kazhal and Bawar Company purchased land in fee for \$950,000. A qualified appraiser made the following estimate of the fair market values of the surface and mineral rights: Surface rights \$1,200,000, Mineral rights \$800,000.

The company also acquired additional 700 acre of proved property, the cost of acquisition include \$400 per acre, processing fee of one quarter value of total purchase fee.

Required : Calculate the total acquisition cost and state the journal entry for each acquisition.

- **Exploration and Appraisal Costs:** These are cost associated with geological, geophysical and other pre-drilling costs, remuneration. It also include costs of drilling. They also include depreciation, amortization and allocated operating costs of support equipment facilities.
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**Development Costs:** These are costs incurred to gain access to proved reserves and provide facilities for drilling, lifting, treating, gathering and storing oil and gas. They include depreciation and allocated operating costs of support equipment facilities

# Example- Development Cost

Karzan and Sarbast Company drilled several successful exploratory wells on Lease A. As a result, Lease A was classified as a proved property, and the proved area was identified. The Company decided in 2018 to drill an additional well within the proved area.

Karzan and Sarbast Oil Company began installing flow lines. The flow lines cost \$300,000, and installation charges were \$25,000. They al

so paid \$240,000 for leasing the area, \$20,000 as legal fees during the acquisition of the mineral right. The company equally pays the contractor \$800,000, including IDC of \$750,000 and equipment costs totaling \$50,000. The well was plugged and abandoned for an additional \$20,000. Assume instead that the well was successful and that additional IDC of \$75,000 and equipment costs of \$200,000 were incurred to complete the well.

**Required: Calculate the accurate development cost and make the appropriate journal entries in the book of Karzan and Sarbast for the relevant year.**



# Tangible Drilling Expenses:

- Casing (production and surface)
- Tubing
- Well head and subsurface
- Pumping units
- Tanks
- Separators
- Heater-treaters
- Engines and automotives
- Flow line
- Installation costs of equipment
- Sundry equipment

**Intangible Drilling Expenses: Intangible Cost:** This is cost that result in assets that have no physical properties, or assets that have physical properties but that cannot be salvaged at the end of an operation.

- Drilling contractors' charges
- Site preparation, roads, pits
- Bits, reamers, tools
- Labour
- Fuel, power and water
- Drill stem tests
- Coring analysis
- Geological and engineering
- Cementation
- Completion, fracturing, acidizing, perforating
- Rig transportation, erection and removal
- Overhead
- Other services

# Calculation of Tangible and Intangible Cost

Oil Company, a joint venture operator, incurred the following costs in drilling an oil well. You are required to classify them into tangible and intangible drilling costs.

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i. Drilling Service fee (on footage basis)	675,256
ii. Cost of clearing and grading unpaved roadways to the drill site	23,560
iii. Construction of overflow mud pits	56,700
iv. Surface casing used in the well	675,908
v. Services such as acidizing and testing	246,200
vi. Cementing services for casing	17, 890
vii. Tubing and control valves	57, 500
viii. Flow lines, tanks and treaters	116, 700
ix. Labour to install lines and tanks	26, 500

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