



Oil & Gas Accounting 101

*Get started with Oil & Gas Accounting!
This eBook will go over the basics of
accounting for oil & gas.*



SherWare

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Introduction



Oil & Gas accounting isn't that difficult to understand. You may have heard the term "Accounting is Accounting", and that's true. Oil & Gas Accounting is still accounting, but with its own terminology and twists.

This eBook will help you to gain a better understanding of what Oil & Gas accounting is and what it isn't. We'll start by going over some of the terminology unique to the oil & gas industry so understanding the concepts will be easier when you encounter terms that may not have been familiar to you.

Then, we'll look at the unique relationship between the wells that are drilled and the people that must be paid for any oil & gas production the well produces.

Next we'll cover revenue and how it is paid out and accounted for and then we'll cover well expenses, amounts held in suspense.

Lastly we'll cover reporting. This includes profit and loss (financials) as well as year-end reporting.

Let's get started...



Terminology



Authorization for Expenditure (AFE): A document shown to investors in a well that will estimate drilling and completion costs. An AFE can then be used as drilling occurs to show actual costs versus estimated costs.

Barrel (BBL) – The basic unit for measuring oil. A barrel is equal to 42 U.S. gallons.

Crude Oil – Liquid petroleum as it comes out of the ground. Crude oil varies radically in its properties, such as specific gravity and viscosity.

Delay Rental: Paid to the lessee (person or company who leased the land to be drilled upon) to retain concession if production is not taking place on the land.

Intangible Drilling Costs (IDC): All costs incurred in drilling a well other than equipment or leasehold.

Intangible Completion Costs (ICC): Costs incurred with completing a well that are non-salvageable if the well is dry or not including labor, materials, rig time, etc.

Joint Interest Billing Statement: The monthly statement sent from the operator to all the working interest holder's within an oil and gas property detailing the expenses charged each month.

Lease – The instrument by which a leaseholder or working interest is created in minerals.

Leasehold Costs – The costs associated with obtaining and keeping a lease on a parcel of land on which a well is drilled.

Legal Suspense – Amounts held in suspense instead of being paid to an owner. Reasons for holding the suspense could be they moved with no forwarding address, a title dispute on the lease or they haven't reached the minimum check amount set by the operator.

MCF – Thousand Cubic Feet. The standard unit for measuring the volume of natural gas.

Natural Gas – Hydrocarbons, which at atmospheric conditions of temperatures and pressure, are in a gaseous phase.

Terminology

Owner Deficit – Amounts held in suspense when a working interest owner, who's expenses are being netted from their revenue, has expenses that exceed their revenue.

Payout: When the costs of drilling, producing and operating a well have been recouped from the sale of the products of the well

Revenue Statement: The monthly statement sent from either the purchaser or operator to all the interest holder's within an oil and gas property detailing the expenses and revenue charged or received each month.

Royalty – The landowner's share of production, before the expenses of production.

Severance Tax – A tax on the removal of minerals from the ground. The tax can be levied either as a tax on volume or a tax on value. In Louisiana oil is taxed at 10 cents per BBL and Natural gas is taxed at 5 cents per MCF.

Spudding In – The first boring of the hole in the drilling of an oil well.

Tangible Completion Costs: Lease and well equipment costs incurred from completing a well.

Tangible Drilling Costs: Actual costs of drilling equipment.

Well – A hole drilled in the earth for the purpose of finding or producing crude oil or natural gas or providing services related to the production of crude oil or natural gas.

Working Interest: An interest in an oil and gas well that shares the expense associated with drilling, completing or operating a well, as well as the share in the revenue made on the well



Overview of Oil & Gas Accounting

Oil has been used for lighting purposes for many thousands of years. In areas where oil is found in shallow reservoirs, seeps of crude oil or gas may naturally develop, and some oil could simply be collected from seepage or tar ponds.

Historically, we know the tales of eternal fires where oil and gas seeps ignited and burned. One example is the site where the famous oracle of Delphi was built around 1,000 B.C. Written sources from 500 B.C. describe how the Chinese used natural gas to boil water.

It was not until 1859 that "Colonel" Edwin Drake drilled the first successful oil well, with the sole purpose of finding oil. The Drake Well was located in the middle of quiet farm country in northwestern Pennsylvania, and sparked the international search for an industrial use for petroleum.

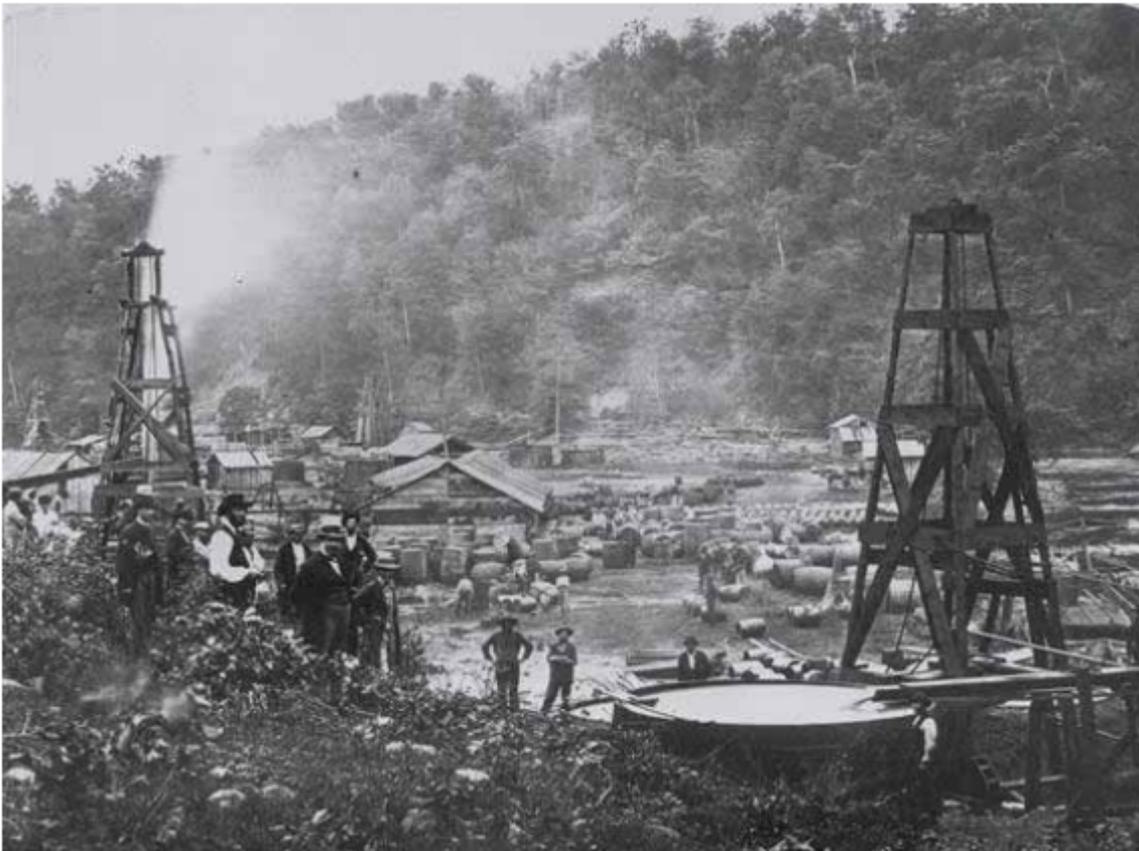


Photo: Drake Well Museum Collection, Titusville, PA

How a Well Comes to Be

So how does a well get drilled? How do they determine where to drill the well? How are they sure where oil & gas will be found?

An oil & gas operator will research different areas where oil & gas has been found in the past. But before they can begin drilling, they have to have permission to drill from the landowner and/or mineral owner where the well is to be drilled. They will need to get a **Lease** from the landowner and/or mineral owner in order to drill on their property. A lease is a legal document that spells out what the operator or owner of the lease will do for the landowner for the permission or right to drill wells on their property. There are also payments involved in order to get the lease. These payments consist of a lease bonus of so many \$ per acre being leased.

Usually, in order to keep the lease until a well is drilled, the operator has to pay **Delay Rental Payments** to the landowner of so much per acre per year.

Production from the well will be paid to the landowner (hereinafter called the **Royalty** owner). The amount paid is typically 12.5% - 25% of the production before expenses.

Sometimes, the person who found the lease and did all the work in getting it signed, called the Land Man, is paid by giving them a percentage of the production from the wells on the lease. This is called an **Overriding Royalty**. This percentage usually varies from 1% - 5%.

The people who provide the money to drill the well are called **Working Interest** owners. Their percentage is based on the amount of money they invested. Working interest owners share in the expenses incurred during the drilling and production phases of a well.



Non-Operating Interest

All economic interests other than the working interest are non-operating interest. The owner of a non-operating interest bears none of the risk or cost of developing or operating the oil and gas property. Common non-operating interest include:

- Landowner royalties
- Overriding royalties
- Net profits interest
- Production payments

Landowner Royalties

The owner of the minerals in place generally retains a royalty interest, which is specified in the lease as a fraction or percentage of the total value of the oil and gas production. This royalty is commonly known as a landowner royalty.

Overriding Royalties

An overriding royalty is created out of the working interest. Since it is created out of working interest, its life cannot exceed that of the working interest. The interest can either be “carved out” or “retained”. The working interest owner sometimes “carves out” a non-operating interest in exchange for services related to the acquisition and development of the property. An overriding royalty interest is also created when a working interest owner, under a “farmout” arrangement, transfers the working interest to another party and retains an overriding royalty.

Net Profits Interest

Like overriding royalties, a net profits interest is created (carved out or retained) out of the working interest. The primary difference between the two types of interest is how the owner’s share of gross production is measured. Under a net profits arrangement the owner’s share is calculated as a percentage of the net profits from the property. As a result, the owner of a net profits interest would receive no income if there were a loss from operations. The definition of net profits is critical, and should be clearly defined in the contract creating the interest.

Production Payments

A production payment is a right to receive a share of production until a specific amount has been received. It is either carved out or retained from the working interest, and bears none of the development or operating costs.

Under Internal Revenue Code Section 636, a production payment is generally treated as a mortgage loan on the property. Payments received are loan payments. Production payments treated as mortgage loans are not considered to be an economic interest.

Division of Interests

The percentages that determines the amounts paid to the different people or entities participating in the well is called the **Division of Interests** or **Division Order**. The division order is a document spelling out what the owners in the well are to be paid and when.

The interests (percentages) that make up the division of interests are typically determined in the following manner:

Royalty Owners – paid the percentage their land makes up of the entire drilling unit. If they own 100% of the land the well is drilled on they would typically get a 12.5% royalty.

Overriding Royalty Owners – typically paid around 3%.

Working Interest Owner – pays their share of the expenses based on the amount they invested in the well. If they put up 50% of the cost of the well, they would get a 50% working interest.

The working interest owner's share of the revenue is determined by first subtracting the royalties paid from 100% and then multiplying the remainder by their working interest.

EXAMPLE:

Assume a well has a 12.5% royalty and an overriding royalty of 3.0%. The royalties are paid first so this would leave 84.5% for the working interest owners.

$$100.0\% - 12.5\% - 3.0\% = 84.5\%$$

Owner Type	Expenses Pct	Revenue Pct
Royalty		12.500%
Overriding Royalty		3.000%
Working Owner 1:	75.00% * 84.50%	= 63.375%
Working Owner 2:	<u>25.00% * 84.50%</u>	<u>= 21.125%</u>
Well Totals:	100.00%	100.000%

Division of Interest %	Working	Credit To	Acct No.	Post Office Address
0.125000	0.000000	John Appleby	100	PO Box 223 Orrville, OH 44867
0.437500	0.200000	Ph's Energy Exploration	103	PO Box 209 Apple Creek, OH 44806
0.437500	0.800000	Shenwood Operating LLC	104	9907 Greenwood Turnpike

Division Orders will include:

- Name of the oil & gas company
- Legal description of the property
- Type of Interest
- Your decimal interest

You provide:

- Your signature
- Tax ID or SSN
- Address



Distribution Example

Gas Revenue	\$5,000.00
Expenses	\$2,500.00

Revenue

Royalty:	\$5,000 * .125	= \$ 625.00
Override:	\$5,000 * .03	= \$ 150.00
WI Owner 1:	\$5,000 * .63375	= \$3,168.75
WI Owner 2:	\$5,000 * .21125	= <u>\$1,056.25</u>
Total Disbursed:		\$5,000.00

Expenses

WI Owner 1:	\$2,500 * .75	= \$1,875.00
WI Owner 2:	\$2,500 * .25	= <u>\$ 625.00</u>
Total Billed:		\$2,500.00

Accounting Methods

Most small independent producers, who are not required to use a GAAP method of accounting, use a tax method of accounting or a hybrid of successful efforts and tax. The rules for tax accounting are set forth in the Internal Revenue Code and the corresponding Treasury Regulations.

The general rule for accounting methods in the Internal Revenue Code states:

Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. (IRC Sec. 466(a))

It must be established that the method used to “keep the books” is an acceptable method. This code section goes on to define the permissible methods. The permissible accounting methods under IRC Sec. 466(c) are:

- Cash receipts and disbursement method (cash method),
- Accrual method,
- Any other method permitted under the law, and
- Any combination of the methods permitted under the regulations

The accounting method used must clearly reflect income and be consistently applied. Treas. Reg. Sec. 1.446-1 states:

It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are in his judgment best suited to his needs. However, no method of accounting is acceptable unless it clearly reflects income... provided all items are treated consistently from year to year.

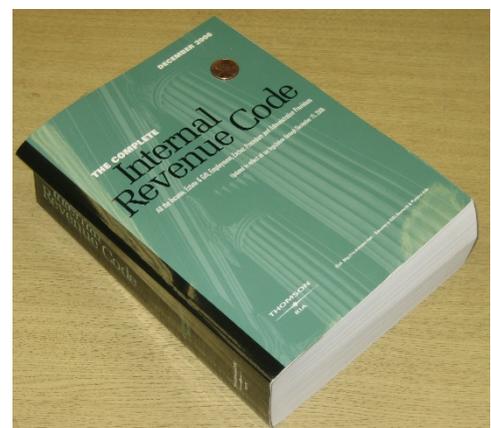


Chart of Accounts

Accounting for Oil & Gas requires a good set of accounts which are used to keep track of all accounting activities. This list of accounts is called the “Chart of Accounts” and will be every account needed for oil & gas operations accounting.

There are two main sections of the chart of accounts, which are, Balance Sheet accounts and Income Statement or Profit & Loss accounts.

Balance Sheet accounts consist of categories such as Assets, Liabilities and Equity. Assets are items of value owned by the company. Liabilities are obligations of the company to transfer something of value, like an Asset, to another party. Equity is the value of the assets contributed by the owners of the company.

Income Statement accounts consist of categories such as Revenue, Cost of Goods Sold and Expenses. Revenues are the result of the sale of production, oil & gas, from the wells. Revenues can also result from services provided or the gains on equipment sold. Cost of Goods Sold are the costs related to the sales of production or services provided. Expenses are the costs incurred in order to operate the wells and company.

The account in the chart of accounts are crucial to good accounting. For every transaction in your accounting system, one account will be debited and one account will be credited. This keeps the accounting system in balance.

For example, when you pay your telephone bill, you will take money from your cash account (credit) to pay the bill and you’ ll recognize the telephone expense by debiting the telephone expense account for the same amount.

Debits and credits will be discussed more in the Revenue Accounting and Expense Accounting sections.

Chart of Accounts	
1000	- Assets
1010	- Cash
1020	- Money Market
1030	- Expenses To Be Billed
1100	- Fixed Assets
1110	- Properties
1120	- Buildings
1130	- Equipment
2000	- Liabilities
2010	- Accounts Payable
2020	- Revenue Payable
2030	- Production Taxes Payable
3000	- Equity
3010	- Shareholder Equity
3020	- Current Earnings
3030	- Retained Earnings
4000	- Revenue
4010	- Oil Revenue
4020	- Gas Revenue
...	

Revenue Accounting

One of the main tasks in oil & gas accounting is accounting for the revenue being produced by the wells and paid out to the owners. Here is where we start talking about debits and credits.

Before we get into debits and credits, let's talk about the challenges of accounting for revenue in the oil & gas industry. In most other industries, the product is made, the price is set, then it's sold and cash is received. The transaction is booked as a simple two-sided accounting entry debiting cash and crediting revenue.

In the oil & gas industry, we have to manage booking revenue for a product whose price is a moving target and whose inventory is mostly unknown. Oil and gas producers' main assets are the minerals in place on the developed and undeveloped properties it holds. Most of these properties have been leased by the producers. These minerals in place are known as reserves. The accounting for oil and gas reserves requires the use of estimates made by petroleum engineers and geologists. Reserves estimation is a complex, and imprecise process.

Once properties are producing, the oil and gas reserves related to the producing properties will deplete resulting in a decline in production from the properties.

An independent oil and gas producer's revenue consists primarily of:

- Oil and gas revenue
- Operating revenue
- Income from the sale or sublease of property
- Income from hedging transactions.

Let's take a look at each of these.



Oil and gas revenue

For producers the majority of the oil and gas revenue will be in the form of working interest. Overriding royalties are also common, while landowner royalties are less common for exploration and production companies. Oil and gas revenue might also be in the form of a net profits interest and production payments.

Operating revenue

Some operators generate income from operating wells, supervising drilling, transporting gas, hauling and disposing salt water, and other activities incidental to their operations.

Sale or sublease of property

Producers frequently sell or sublease property. Transactions include both developed and undeveloped property. Distinguishing between a sale and a sublease is critical for tax purposes.

Hedging transactions

Some exploration and production companies use derivatives in their operations to hedge risk associated with oil and gas prices. Derivatives are financial instruments whose values are derived from the value of an underlying asset. Typically, oil and gas companies use futures, options and swaps.



Posting Revenue

How revenue is posted depends on the method of accounting being used. The two methods are Accrual and Cash. These methods differ in the timing of when transactions are either debited or credited to your accounts.

Under the **Accrual** method transactions are posted when a sale is made or an expense is incurred regardless of whether money for them is received or paid.

The **Cash** method is the more commonly used method of accounting in small business, especially small independent oil & gas companies. Under the Cash method, income is not posted until money, (cash or check), is received, and expenses are not posted until they are actually paid.



Here's a posting example using the cash method: On February 1st, 2015 you receive \$25,500 of oil revenue. Your operating company owns a 25% net revenue interest in the wells that produced the oil.

Account	Date	Debits	Credits
Cash - Operating	2/1/2015	\$25,500	
Revenue Payable	2/1/2015		\$25,500

When you process a revenue distribution and pay the royalty and working interest owners, you'd make the following posting:

Account	Date	Debits	Credits
Cash - Operating	2/1/2015		\$19,125
Revenue Payable	2/1/2015	\$25,500	
Oil Revenue			\$6,375



In the previous example, the amount received would be posted to revenue payable because not 100% of the receipt is recognized as your oil revenue since you only own a 25% NRI. It is held in the revenue payable account until a distribution is run that pays the owners their proportional share.

Revenue accounting, as a whole, is much more complicated than this simple example but it should give you the gist of how revenue is handled.

There are other revenue transactions such as charging out production and severance taxes as well as state income taxes. There can also be gas revenue natural gas liquid revenue as well as marketing expenses that all need to be allocated and paid or withheld from the owners of the wells check.

For more information on Revenue Accounting and oil & gas accounting as a whole, check out the Council of Petroleum Accounting Societies or COPAS for short. They are the standardizing body for oil & gas accounting and set the guidelines for how to account for revenue and expenses. (www.copas.org)



The amount received is posted to revenue payable because not 100% of the receipt is recognized as your oil revenue since you only own a 25% NRI.

Expense Accounting

Due to the capital intensive, high-risk nature of developing oil and gas properties, companies routinely combine their capital and knowledge in joint operations to share the cost and reduce risk. These sharing arrangements usually involve the transfer an operating interest or non-operating interest by one party to another in exchange for a contribution to the project.

Farm-out

In order to develop a property, the owner of an operating interest (working interest) may transfer (farm-out) the operating interest. In a farm-out arrangement some of the entire burden for developing the property is transferred to another person. In exchange for assuming the burden, the transferee receives the operating interest in the property.

As a part of the transaction, a non-operating interest is partitioned out of the operating interest and retained by the owner. The retained interest is usually an overriding royalty, but could also be a net profits interest or a production payment. In a farm-out arrangement, the assignor of the mineral interest will transfer any leasehold cost from the operating interest to the non-operating interest.

Joint Ventures

Joint ventures are a type of sharing arrangement. A joint venture is a non-incorporated association of two or more persons or companies who pool their



resources to drill, develop, and operate an oil and gas property or properties. Each owner has an undivided interest in the property. Joint ventures may be created in several ways, some of the most common being:

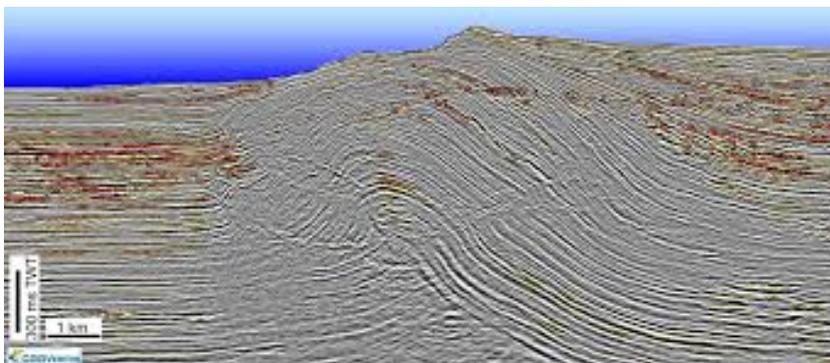
- Two or more operators lease a single property as joint lessees.
- A working interest owner assigns an undivided fractional share of the property to another person or company in exchange for cash, property or services contributed to the “pool of capital” necessary to develop the property.
- Working interest is assigned to another operator under a carried interest arrangement.

An operator's expenses associated with the operation of oil & gas wells could consist of:

•**Intangible Drilling Costs** - Intangible drilling costs (IDCs) include all expenses made by an operator incidental to and necessary in the drilling and preparation of wells for the production of oil and gas, such as survey work, ground clearing, drainage, wages, fuel, repairs, supplies and so on. Broadly speaking, expenditures are classified as IDCs if they have no salvage value. The following is a non-exhaustive list of potential IDCs incurred in the exploration and development of oil & gas wells.

- Administrative costs in connection with drilling contracts.
- Survey and seismic costs to locate a well site.
- Cost of drilling.
- Grading, digging mud pits, and other dirt work to prepare drill site.
- Cost of constructing roads or canals to drill site.
- Surface damage payments to landowner.
- Crop damage payments.
- Costs of setting rig on drill site.
- Transportation costs of moving rig.
- Technical services of geologist, engineer, and others engaged in drilling the well.
- Drilling mud, fluids, and other supplies consumed in drilling the well.
- Transportation of drill pipe and casing.

•**Intangible Completion Costs** - Similar to IDCs these expenses are related to non-salvageable completion costs, including labor, completion materials used, completion rig time, drilling fluids etc. Intangible completion costs are also almost always deductible in the same year they take place, and usually make up about 15% of the overall well cost.



- **Tangible Drilling Costs** - Expenditures necessary to develop oil or gas wells, including acquisition, transportation and storage costs, which typically are capitalized and depreciated for federal income tax purposes. Examples of such expenditures include:

- Well casings
- Wellhead equipment
- Water disposal facilities
- Metering equipment
- Pumps
- Gathering lines
- Storage tanks
- Gas compression and treatment facilities

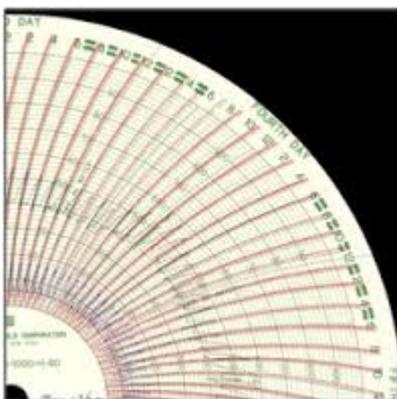


- **Leasehold Acquisition Costs** - The cost and expenses associated with acquiring properties, including:

- Property Rentals
- Lease Bonuses
- Legal Fees
- Right of Ways

- **Lease Operating Expenses** – The costs associated with operating a producing well. Lease operating expenses can include:

- Pumping
- Administrative Fees
- Chart Integration
- Electric
- Data Processing
- Supplies



Posting Expenses

Expenses are posted most usually to Accounts Payable when the bill comes in. The offset to this posting will usually be an asset account with a name something like, “Well Expenses Billable”. If you’re going to process the expenses in either a Revenue Distribution, if you’re netting them or a joint-interest-billing, if they’re being billed to the working interest owners, you need a place the expenses can sit until they’re processed.

Here’s some examples of expense posting when a \$1,400 bill for pumping is received.

Account	Date	Debits	Credits
Accounts Payable	2/1/2015		\$1,400
Well Expenses Billable	2/1/2015	\$1,400	

Assuming that your operating company has a 25% working interest in the well, the posting, when the expenses are processed, would look like the following:

Account	Date	Debits	Credits
Joint Interest Receivable	2/15/2015	\$1,050	
Well Expenses Billable	2/15/2015		\$1,400
Pumping Expense	2/15/2015	\$350	

The reason that only \$1,050 posted to the JIB receivable account is that your company owned 25% of the well so it got 25% of the expense. This portion, or \$350, posts to the Pumping expense account so it affects your P&L.

For more information on Expense Accounting and oil & gas accounting as a whole, check out the Council of Petroleum Accounting Societies or COPAS for short. They are the standardizing body for oil & gas accounting and set the guidelines for how to account for revenue and expenses. (www.copas.org)

Reporting

The four main financial statements include:

- Balance sheet
- Income statement
- Cash flow statement
- Statement of stockholder' s (partner' s or member' s) equity

Balance Sheet

The balance sheet provides detailed information about a company' s assets, liabilities and stockholder' s (owner' s) equity.

Assets are things a company owns that have value. Typically this means they can either be sold or used by the company to produce products or provide services.

Liabilities are the amounts of money that a company owes to others. The difference between the total assets and the total liabilities is the equity of the owners. A company' s assets have to equal or “balance”, the sum of its liabilities and owner' s equity.

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

A balance sheet shows a snapshot of a company' s assets, liabilities and equity at the end of the reporting period. It does not show the flows into and out of the accounts during the period.



Here's an example of what an operating company's Balance Sheet might look like:

**Operating Company
Balance Sheet
As of 12/31/2014**

ASSETS

Current Assets

Cash - Checking	99,500	
Cash - Savings	<u>101,500</u>	
		201,000
Accounts Receivable		249,300
Inventory		105,200
Drilling In Progress	<u>450,000</u>	
Total Current Assets	804,500	

Property and Equipment

Leasehold Costs	2,500,000	
Accumulated Depl - L/H Costs	(750,000)	
Geological & Geophysical	350,000	
Accum. Amort - G&G	(275,000)	
Well & Lease Equipment	3,200,000	
Accum. Depreciation	<u>(995,000)</u>	
Total Property		<u>4,030,000</u>
Total Assets		<u>4,834,500</u>

LIABILITIES & EQUITY

Current Liabilities

Accounts Payable	102,000	
Taxes Payable	17,500	
Payroll Taxes Payable	<u>5,435</u>	
Total Current Liabilities		109,185

Stockholders Equity

Common Stock	5,000	
Retained Earnings	3,255,200	
Current Earnings	<u>1,355,930</u>	
Total Stockholders Equity		<u>4,616,130</u>

Total Liabilities and Equity		<u>4,834,500</u>
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Income Statement

An A financial statement that measures a company's financial performance over a specific accounting period. Financial performance is assessed by giving a summary of how the business incurs its revenues and expenses through both operating and non-operating activities. It also shows the net profit or loss incurred over a specific accounting period, typically over a fiscal quarter or year.

Also known as the "profit and loss statement" or "statement of revenue and expense."

The income statement is divided into two parts: the operating and non-operating sections.

The portion of the income statement that deals with operating items is interesting to investors and analysts alike because this section discloses information about revenues and expenses that are a direct result of the regular business operations. For example, for an oil & gas producing company the operating items section would talk about the revenues and expenses involved with the production of oil & gas.

The non-operating items section discloses revenue and expense information about activities that are not tied directly to a company's regular operations. For example, if the oil & gas company sold an old field office and some old equipment, then this information would be in the non-operating items section.



Here's an example of what an operating company's Income Statement might look like:

**Operating Company
Income Statement
As of 12/31/2014**

Revenues	
Oil Sales	1,899,500
Gas Sales	1,101,500
Royalties	11,000
Operating Income	<u>22,700</u>
Total Revenues	3,234,700
 Cost of Operations	
Lease Operating Expense	71,300
Severance Tax	8,700
Dry Hole Costs	100,000
Depreciation, Depletion & Amortization	250,000
Intangible Drilling Costs	<u>450,000</u>
Total Current Assets	780,000
 General and Administrative Expenses	
Officer's Salaries	300,000
Other Salaries	450,000
Payroll Taxes	60,000
Rent	25,000
Supplies - Office	6,000
Meals & Entertainment	2,000
Insurance	2,050
Depreciation	<u>10,000</u>
Total General & Administrative	850,050
 Other Income (Expense)	
Interest Income	2,000
Interest Expense	(62,000)
Contributions	<u>(2,000)</u>
Total Other Income (Expense)	(62,000)
 Net Income Before Taxes	 1,813,230
Income Taxes	<u>(457,300)</u>
 Net Income	 1,355,930

Cash Flow Statement

Cash flow statements report a company's inflows and outflows of cash. While the income statement tells whether a company made a profit, a cash flow statement tells whether the company generated cash. The cash flow statement uses and reorders the information from a company's balance sheet and income statement.

The bottom line of the cash flow statement shows the net increase or decrease in cash for the reporting period. In arriving at the bottom line, the statement reports cash flow from: (1) operating activities; (2) investing activities; and (3) financing activities.

The Cash Flow Statement is especially useful for companies using the accrual method of account since a big sale would be recorded as revenue even though the cash may not have been received yet.



Here's an example of what an operating company's Cash Flow Statement might look like:

**Operating Company
Cash Flow Statement
As of 12/31/2014**

Cash Flow From Operating Activities

Net Income	\$ 1,686,000
Add Depletion, Depreciation and Amortization	610,000
Gain on Sale of Oil and Gas Properties	(500,000)
Abandonment Expense	75,000
Dry Hole Costs	100,000
Intangible Drilling Costs	600,000
Increase in Accounts Receivable	(10,000)
Decrease in Inventory	25,000
Increase in Prepaid Insurance	(2,000)
Decrease in Prepaid Drilling	100,000
Decrease in Accounts Payable	(12,000)
Decrease in Taxes Payable	(4,000)
Increase in Income Tax Payable	550,000
Increase in Accrued Expenses	<u>40,000</u>

Net Cash Flow From Operating Activities 3,258,000

Cash Flow From Investing Activities

Acquisition and Dev of Oil & Gas Properties	(2,000,000)
Proceeds From Sale of Oil and Gas Properties	600,000
Purchase of Equipment and Vehicles	<u>150,000</u>

Net Cash Flow From Investing Activities (1,250,000)

Cash Flow From Financing Activities

Principal Paid on Bank Borrowings	(850,000)
Dividends Paid to Shareholders	<u>(93,000)</u>

Net Cash Flow From Financing Activities (943,000)

Increase in Cash **1,065,000**

Cash at Beginning of the Period 535,000

Cash at the End of the Period **\$1,600,000**

Regulatory Reporting

The oil and gas industry is highly regulated, and a significant burden is placed upon producers to comply with laws and regulations of various federal, state and local agencies. Good accounting practices and systems enable companies to comply with the various agencies' reporting requirements.

Summary

Oil & Gas Accounting is just accounting but it helps to know some of the terminology and where the numbers are coming from that affect your accounting system. This guide gave you the basics. Now you can start digging deeper, if you want.

There are a lot of tax consequences associated with how transactions are posted for oil & gas companies. Stay tuned.... We will be coming out with an Oil & Gas Accounting 201 guide that will take the concepts in this manual a little further.

More information:

We offer three software programs to handle oil and gas accounting.

- The [Accounting Manager](#) is a full accounting program that handles the accounting side and oil and gas distributions in one program
- [The Disbursement and JIB Manager](#) is a stand alone program that only tracks your oil and gas distributions if you have an accounting system you like.
- [The Disbursement and JIB Manager Integrated Edition](#) is an oil and gas accounting software that integrates directly with your QuickBooks company.

Not sure which program is right for you?

Check out our 5-minute guide to our revenue distribution & joint interest billing software

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