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Heads Up

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If adopted, the ASU would be effective for annual reporting periods ending on or after December 31, 2009.

FASB Proposes to Modernize Oil and Gas Company Reporting.

by Ryan Johnson, Tiffany Prudhomme, Phillip Hilsher, and Beth Ann Reese, Deloitte & Touche LLP

Background

On September 15, 2009, the FASB issued an exposure draft (ED) of a proposed Accounting Standards Update (ASU), *Oil and Gas Reserve Estimation and Disclosures*. The purpose of the ED is to align the current reserve estimation and disclosure requirements of ASC 932[1] with the requirements in the SEC's final rule, *Modernization of the Oil and Gas Reporting Requirements* (the "SEC Final Rule"), which was issued in December 2008. The SEC Final Rule modernized and updated the SEC's requirements for an entity's calculation and disclosure of oil and gas reserves and related definitions to align them with current practices and improvements in technology.

The ASU would avoid an entity's having to perform two reserve calculations and provide two sets of disclosures under both the SEC Final Rule and ASC 932. It would therefore help avoid confusion among financial statement users.

Editor's Note: ASC 932 comprises guidance previously contained in Statements 19[2] and 69,[3] Interpretations 33[4] and 36,[5] and FSP FAS 19-1.[6]

Comments on the ED are due by October 15, 2009. If adopted, the ASU would be effective for annual reporting periods ending on or after December 31, 2009, and would be applied prospectively as a change in estimate. Early application would not be permitted.

Key Revisions

The FASB made several revisions to ASC 932 that are intended to align the requirements for oil and gas reporting under GAAP with the requirements of the SEC Final Rule, including adding to and amending ASC 932's definitions in the Codification's master glossary (e.g., reliable technology and reasonable certainty). Key provisions include expanding the definition of "oil- and gas-producing activities" to include nontraditional resources in reserves, amending the definition of "proved oil and gas reserves" to change the pricing used to estimate reserves, providing guidance on "geographic area" with respect to disclosure of information about significant reserves, and clarifying disclosures required for equity method investments. See below for additional information about each key revision.

[1] Accounting Standards Codification Topic 932, *Extractive Industries — Oil and Gas*.

[2] FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*.

[3] FASB Statement No. 69, *Disclosures About Oil and Gas Producing Activities* — an amendment of FASB Statements No. 19, 25, 33, and 39.

[4] FASB Interpretation No. 33, *Applying FASB Statement No. 34 to Oil and Gas Producing Operations Accounted for by the Full Cost Method* — an interpretation of FASB Statement No. 34.

[5] FASB Interpretation No. 36, *Accounting for Exploratory Wells in Progress at the End of a Period* — an interpretation of FASB Statement No. 19.

[6] FASB Staff Position No. FAS 19-1, "Accounting for Suspended Well Costs."

Inclusion of Nontraditional Resources

Existing Definition	Proposed Amendment
Oil- and gas-producing activities include only crude oil, including condensate and natural gas liquids, and natural gas.	Oil- and gas-producing activities also include "nontraditional resources," if they are intended to be upgraded to synthetic oil and gas.

ASC 932 currently limits oil- and gas-producing activities to those that "involve the acquisition of mineral interests in properties, exploration (including prospecting), development, and production of **crude oil, including condensate and natural gas liquids, and natural gas**" (emphasis added). Under ASC 932-10-15-3, the extraction of hydrocarbons from shale, tar sands, or coal is outside the scope of ASC 932.

The ED proposes to expand the scope of ASC 932 to include the "extraction of saleable hydrocarbons, in the solid, liquid, or gaseous state, from oil sands, shale, coalbeds, or other nonrenewable natural resources that are **intended** to be upgraded into synthetic oil or gas, and activities undertaken with a view to such extraction" (emphasis added). An entity would be prohibited from including such nontraditional resources that are **not intended** to be upgraded into synthetic oil or gas.

The ED proposes to amend, for both accounting and disclosure purposes, the definition of proved oil and gas reserves to require 12-month average pricing, which is consistent with the requirements of the SEC's Final Rule.

Nontraditional resources would, therefore, also be included in the supplemental disclosures required for oil and gas operations under ASC 932. Specifically, an entity would be required to disclose, as of the beginning and end of the year, net quantities of its interests in proved oil and gas reserves, proved developed oil and gas reserves, and proved undeveloped oil and gas reserves of each of the following: crude oil (including condensate and natural gas liquids), natural gas, synthetic oil, synthetic gas, and sales products of other nonrenewable natural resources that are intended to be upgraded into synthetic oil and gas. See the appendix for an example of the proposed reserve quantity information table from the ED.

Editor's Note: In addition to the required disclosures, the SEC Final Rule permits registrants to disclose probable and possible reserves. Such disclosures could provide investors with more insight into the potential reserves base. The FASB's ED is silent regarding disclosure of probable and possible reserves.

Pricing Used to Estimate Reserves

Existing Requirement	Proposed Amendment
Entities use the price as of the date the estimate is made (i.e., the price as of the end of the period) to estimate reserves.	Entities use a 12-month average price to estimate reserves.

Under the current ASC definition of **proved oil and gas reserves,** entities must estimate reserves by using the price "as of the date the estimate is made," including "consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future considerations." Some believe that the use of single-day period-end pricing subjects reserve estimates to volatility and seasonality.

The SEC Final Rule requires that when estimating reserves, registrants use 12-month average pricing to reduce the effects of volatility and seasonality. If the FASB were not to amend ASC 932, registrants would need to maintain two sets of reserve estimates to comply with the SEC's rules and the accounting and disclosure requirements of ASC 932.

The ED proposes to amend, for both accounting and disclosure purposes, the definition of proved oil and gas reserves to require 12-month average pricing, which is consistent with the requirements of the SEC's Final Rule. Under the proposed amendment, entities must estimate reserves by using "the average price during the 12-month period before the ending date of the period covered by the report, determined as an unweighted arithmetic average of the first-day-of-the-month price for each month within such period, unless prices are defined by contractual arrangements, excluding escalations based upon future conditions."

Editor's Note: Capitalized proved oil and gas property costs are evaluated for impairment under ASC 360 (formerly Statement 144[7]). The impairment model in ASC 360 uses undiscounted cash flow analysis and fair value, neither of which is affected by the pricing model in ASC 932.[8]

Disclosure of Significant Reserves in Geographic Areas

Existing Requirement	Proposed Amendment
Proved reserve disclosures must be shown for foreign geographic areas (individual countries or groups of countries) with significant reserves.	Proved reserve disclosures must be shown in the aggregate and separately by geographic areas (individual countries, groups of countries within a continent, or continents) with significant reserves, which include, but are not limited to, each geographic area containing 15 percent or more of an entity's proved reserves.

Although disclosures under the ED must be at least as disaggregated as under the SEC's Final Rule, entities must include disclosures for areas with reserves judged to be significant, even if those reserves may be less than the 15 percent threshold.

The lack of specificity in ASC 932's current disclosure requirements on "foreign geographic areas" has led to differing interpretations among oil and gas entities. To increase comparability, the SEC revised its rules to require registrants to disclose reserve information by geographic area (defined as individual countries, groups of countries within a continent, or continents) when such an area contains 15 percent or more of the registrant's proved reserves (unless disclosing such reserves is prohibited by the country in which the reserves are located).

The FASB agreed with the specific threshold, but also concluded that an entity should consider qualitative information when determining whether reserves are significant. Therefore, the ED adopts the 15 percent threshold to align with the SEC Final Rule but does not replace the term "significant reserves." Thus, although disclosures under the ED must be at least as disaggregated as under the SEC's Final Rule, entities must include disclosures for areas with reserves judged to be significant, even if those reserves may be less than the 15 percent threshold.

Equity Method Investments

Existing Requirement	Proposed Amendment
An entity does not consider equity method investments when determining whether it has significant oil- and gas-producing activities. An entity must disclose summarized equity method investment information separately from disclosures for consolidated investments.	An entity considers equity method investments when determining whether it has significant oil- and gas-producing activities. An entity must disclose consolidated and equity method investments separately, but is permitted to present a total. An entity must disclose equity method investments in the same level of detail as consolidated investments.

ASC 932-810-45-1 (formerly Issue 00-01[9]) permits an entity to consolidate certain investments in the oil and gas industry proportionately (e.g., investments in noncorporate entities such as partnerships in which the partners have an undivided interest in the properties), as long as the entity's activities are limited to the extraction of mineral resources (such as oil and gas exploration and production). These entities apply the equity method to other unconsolidated investments.

ASC 932 currently requires separate disclosures for equity method investments and consolidated investments. An entity must disclose its consolidated operations in greater detail than its equity method investments. Certain FASB constituents have indicated that management does not make business decisions on the basis of the legal form of the entity and that investors would be better served if disclosures for equity method investments were consistent with the disclosures required for proportionately consolidated investments.

[7] FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

[8] For entities that apply the full-cost method, the SEC amended its full-cost accounting rules in Regulation S-X, Rule 4-10(c), to require the use of 12-month average pricing. The SEC also eliminated SEC Staff Accounting Bulletin Topic 12D.3(c), "Effect of Subsequent Events on the Computation of the Limitation of Capitalized Costs," which permitted consideration of the impact of price increases after period-end on the ceiling limitation test.

[9] EITF Issue No. 00-01, "Investor Balance Sheet and Income Statement Display Under the Equity Method for Investments in Certain Partnerships and Other Ventures."

In response to these concerns, the FASB has proposed the following amendments to ASC 932:

a. Equity method investments would be considered in determining whether an entity has significant oil- and gas-producing activities

b. Entities would be required to continue to make separate disclosures for consolidated (including proportionately consolidated) and equity method investments, but would be permitted to also present a total

c. Entities would be required to make disclosures about equity method investments with significant oil and gas producing activities in the same level of detail as is required for consolidated investments.

See the appendix of this *Heads Up* for an example.

Editor's Note: The FASB is seeking feedback from constituents on whether certain equity method investments should be excluded from the required disclosures.

Transition

The ED requires entities to separately disclose an estimate of the effect of applying the amendments on each of the amounts and quantities disclosed in accordance with ASC 932. If this effect is not significant or practical to estimate, entities must state that fact and explain why. Entities must also include and disclose the effect of applying the amendment in ASC 932-10-05-2(d) (regarding inclusion of nontraditional resources) in each of the amounts and quantities disclosed in accordance with ASC 932.

Appendix

The following table, reprinted from the ED, illustrates disclosure requirements for reserve quantity information:

Reserve Quantity Information[a] [c] for the Year Ended December 31, 20XX

	Total	Total — by Product		Continent A		Continent B — Country A		Other Countries in Continent B		Other Continents/ Countries	
	All Products[d]	Oil	Synthetic Oil	Oil	Synthetic Oil	Oil	Synthetic Oil	Oil	Synthetic Oil	Oil	Synthetic Oil
Proved developed and undeveloped reserves (consolidated entities only):											
Beginning of year	X	X	X	X	X	X	X	X	X	X	X
Revisions of previous estimates	X	X	X	X	X	X	X	X	X	X	X
Improved recovery	X	X	X	X	X	X	X	X	X	X	X
Purchases of minerals in place	X	X	X	X	X	X	X	X	X	X	X
Extensions and discoveries	X	X	X	X	X	X	X	X	X	X	X
Production	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Sales of minerals in place	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
End of year	X[b]	X	X	X	X	X	X	X	X	X	X
Proved developed reserves:											
Beginning of year	X	X	X	X	X	X	X	X	X	X	X
End of year	X	X	X	X	X	X	X	X	X	X	X
Proved undeveloped reserves:											
Beginning of year	X	X	X	X	X	X	X	X	X	X	X
End of year	X	X	X	X	X	X	X	X	X	X	X

	Total	Total — by Product		Continent A		Continent B — Country A		Other Countries in Continent B		Other Continents/ Countries	
	All Products[(d)]	Oil	Synthetic Oil	Oil	Synthetic Oil	Oil	Synthetic Oil	Oil	Synthetic Oil	Oil	Synthetic Oil
Oil and gas applicable to long-term supply agreements with governments or authorities in which the entity has the legal right to produce or has a revenue interest in the production:											
Proved reserves — end of year	X	X	X	X	X	X	X	X	X	X	X
Received during the year	X	X	X	X	X	X	X	X	X	X	X
Entity's share of proved developed and undeveloped reserves of investees accounted for by the equity method — beginning of year	X	X	X	X	X	X	X	X	X	X	X
Revisions of previous estimates	X	X	X	X	X	X	X	X	X	X	X
Improved recovery	X	X	X	X	X	X	X	X	X	X	X
Purchases of minerals in place	X	X	X	X	X	X	X	X	X	X	X
Extensions and discoveries	X	X	X	X	X	X	X	X	X	X	X
Production	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Sales of minerals in place	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Entity's share of reserves of investees accounted for by the equity method — end of year	X	X	X	X	X	X	X	X	X	X	X
Total consolidated and equity interests in reserves — end of year	X	X	X	X	X	X	X	X	X	X	X

(a) Oil and synthetic oil reserves stated in barrels.
(b) Includes reserves of X barrels attributable to a consolidated subsidiary in which there is an X-percent noncontrolling interest.
(c) Similar tables shall also be disclosed for gas and synthetic gas reserves and other products.
(d) Includes oil and synthetic oil reserves, gas and synthetic gas reserves and other products. "All products" shall be stated in oil-equivalent barrels.

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