Sample Letter Sent to Oil and Gas Producers

The following letter was sent in February 2004 by the Division of Corporation Finance to registrants identified as being primarily engaged in the production of oil and gas. All registrants with subsidiaries or operations engaged in the production of oil and gas should consider this letter in the preparation of their filings with the Commission.

February 24, 2004

Chief Financial Officer
Company
Address

Re: Company
File No.: xxx-xxxxx

Dear Chief Financial Officer,

As a producer of oil and gas, you are subject to the disclosure requirements of FASB Statement No. 69, Disclosures about Oil and Gas Producing Activities (FAS 69). We have recently become aware of questions that have arisen with respect to the required disclosures of FAS 69 upon the adoption of FASB Statement No. 143, Accounting for Asset Retirement Obligations (FAS 143). After consideration by our staff, including discussions with the FASB staff, and to maintain comparability among oil and gas companies in preparing the FAS 69 disclosures for their 2003 annual report, we offer the following observations about the required disclosures that you should consider in preparing your Form 10-K/KSB.

Among other things, FAS 143 requires the recognition of a liability for a legal obligation associated with the retirement of a long-lived assets that results from the acquisition, construction, development, and (or) the normal operation of a long-lived asset. The initial recognition of a liability for an asset retirement obligation increases the carrying amount of the related long-lived asset by the same amount as the liability. In periods subsequent to initial measurement, period-to-period changes in the liability are recognized for the passage of time (accretion) and revisions to the original estimate of the liability. Additionally, the capitalized asset retirement cost is subsequently allocated to expense using a systematic and rational method over its useful life.

The questions raised concern how recognition of a liability for an asset retirement obligation and the related depreciation of the asset and accretion of the liability under FAS 143 impact the required disclosures under paragraphs 18 through 34 of FAS 69. We note that FAS 143 did not amend FAS 69.

FAS 69 - paragraphs 18-20, Disclosures of Capitalized Costs Relating to Oil and Gas Producing Activities (Capitalized Costs)

We believe the reported carrying value of oil and gas properties should include the related asset retirement costs and accumulated depreciation, depletion and amortization should include the accumulated allocation of the asset retirement costs since the beginning of the respective property's productive life.

The Basis of Conclusions to FAS 143 discusses the Board's conclusion regarding the capitalization of asset retirement costs by stating "a requirement for capitalization of an asset retirement cost along with a requirement for the systematic and rational allocation of it to expense achieves the objectives of (a) obtaining a measure of cost that more closely reflects the entity's total investment in the assets and (b) permitting the allocation of the cost, or portions thereof, to expense in the periods in which the related asset is expected to provide benefits." Excluding net capitalized asset retirement costs from the capitalized costs disclosure would essentially result in a presentation of capitalized costs that is not reflective of the entity's total investment in the asset, which is contrary to one of the objectives of FAS 143.

FAS 69 - paragraphs 21-23, Disclosures of Costs Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities (Costs Incurred)

We believe an entity should include asset retirement costs in its Costs Incurred disclosures in the year that the liability is incurred, rather than on a cash basis.

Paragraph 21 requires an entity to disclose Costs Incurred during the year whether those costs are capitalized or charged to expense. We believe FAS 69 clearly indicates that the disclosure was intended to be on an accrual, rather than a cash, basis. Additionally, FAS 143 requires an entity to recognize the asset retirement costs and liability in the period in which it incurs the legal obligation - through the acquisition or development of an asset or through normal operation of the asset. The cost of an asset retirement obligation is not incurred when the asset is retired and the obligation is settled. Accordingly, an entity should disclose the costs associated with an asset retirement obligation in the period in which that obligation is incurred. That is, the Costs Incurred disclosures in a given period should include asset retirement costs capitalized during the year and any gains or losses recognized upon settlement of asset retirement obligations during the period.

FAS 69 - paragraphs 24-29, Disclosure of the Results of Operations for Oil and Gas Producing Activities (Results of Operations)

We believe accretion of the liability for an asset retirement obligation should be included in the Results of Operations disclosure either as a separate line item, if material, or included in the same line item as it is presented on the statement of operations.

Paragraphs 14 and B57 of FAS 143 specify that the accretion expense resulting from recognition of the changes in the liability for an asset retirement obligation due to the passage of time be classified as an operating item in the statement of income. Therefore, it follows that the accretion expense related to oil and gas properties' asset retirement obligations should be included in the FAS 69 Results of Operations disclosure.

FAS 69 - Paragraphs 30-34, Disclosure of a Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities (Standardized Measure)

We believe that an entity should include the future cash flows related to the settlement of an asset retirement obligation in its Standardized Measure disclosure.

Paragraph 30 states: "A standardized measure of discounted future net cash flows relating to an enterprise's interests in (a) proved oil and gas reserves … and (b) oil and gas subject to purchase under long-term supply, purchase or similar agreements and contracts … shall be disclosed as of the end of the year." We believe that the requirement to disclose "net cash flows" relating to an entity's interest in oil and gas reserves requires an entity to include the cash outflows associated with the settlement of an asset retirement obligation. Exclusion of the cash flows associated with a retirement obligation would be a departure from the required disclosure. However, an entity is not prohibited from disclosing the fact that cash flows associated with asset retirement obligations are included in its Standardized Measure disclosure as a point of emphasis.

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Please call Leslie A. Overton at (202) 942-2960 or Barry Stem at (202) 942-1870 if you have any questions regarding this letter.

Sincerely,

Carol A. Stacey
Chief Accountant

http://www.sec.gov/divisions/corpfin/guidance/oilgasletter.htm