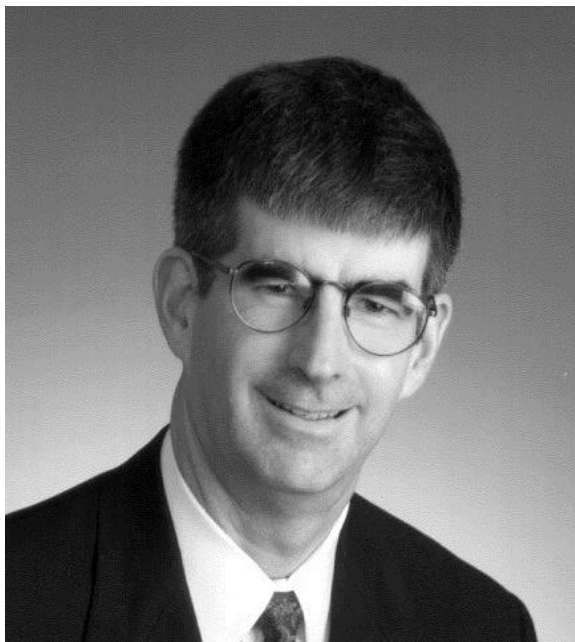


Accounting Hot Topics

API Accounting Subcommittee

29 September 2015



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National Professional Practice

Oil and Gas and Generalist Matters

Today's agenda – Accounting Hot Topics

- ▶ Low oil prices – Accounting considerations
- ▶ FASB update
- ▶ SEC/PCAOB update

Low oil prices

Accounting considerations

- ▶ Credit risk
 - ▶ Allowance for doubtful accounts and revenue recognition
 - ▶ Derivative valuation and hedging
- ▶ Impairment considerations
 - ▶ Inventory lower of cost or market (or net realizable value)
 - ▶ Oil and gas properties and related reserves
 - ▶ Other long-lived asset, equity investment and goodwill impairment considerations
- ▶ Asset retirement obligations
- ▶ Debt and debt covenants
- ▶ Contract modifications
- ▶ Income taxes
- ▶ Subsequent events

Credit risk considerations

Allowance for doubtful accounts and revenue recognition

- ▶ Consider the effect on counterparties, including the valuation of receivables
 - ▶ Troubled counterparties, even those not in formal bankruptcy
 - ▶ “Right of offset” when amounts are also owed to other parties
 - ▶ Rights to collateral
 - ▶ Changes due to assignment (e.g., due to acquisition)

- ▶ In some cases, credit risk may suggest that the fundamental revenue recognition criterion that “collection is probable” is not met
 - ▶ If this criterion is not met, rather than recognizing an allowance, revenue should not be recognized until the collectibility issue is resolved

Credit risk considerations

Derivatives and hedging

- ▶ Credit-risk
 - ▶ Counterparty credit risk in valuation of derivative assets
 - ▶ Nonperformance risk in valuation of derivative liabilities
 - ▶ Effect on hedging relationships depends on hedge designation documentation
- ▶ Effect of novations (including consideration of FASB standard-setting project on novations)
- ▶ Evaluating whether hedged transactions subject to cash flow hedging remain probable
 - ▶ When to reclassify previously deferred amounts
 - ▶ May involve more than credit risk

Additional resources

Financial reporting developments

Derivatives and hedging (SCORE No. BB0977),
including section 4.11, Credit risk in derivative
contracts – accounting considerations

Fair value measurement (SCORE No. BB1462)
including Appendix D, Credit valuation adjustments
for derivative contracts

Inventory

Lower of cost or market (or net realizable value)

- ▶ May affect commodity inventories that have a link to crude prices
 - ▶ Crude oil
 - ▶ Refined products, including transportation fuels
 - ▶ Natural gas liquids

- ▶ May affect other types of inventories
 - ▶ Steel pipes
 - ▶ Spare parts

Inventory

Lower of cost or market (or net realizable value)

- ▶ Lower of cost or market evaluates the loss of the “utility” of inventory
 - ▶ Replacement cost (based on entity’s normal activity – produce vs procure)
 - ▶ Subject to a ceiling (net realizable value or NRV) and a floor (NRV – selling profit)
 - ▶ Considering subsequent events

- ▶ Net realizable value is based on how the entity typically sells the inventory; for example:
 - ▶ Crude oil may be a “finished good” to an upstream entity
 - ▶ Or a raw material that needs to consider conversion costs and the value of gasoline, diesel and other products for some refiners

Inventory

Lower of cost or net realizable value simplification project

- ▶ FASB simplification project
 - ▶ Subsequent measurement of inventory changes from “lower of cost or market” to “lower of cost or net realizable value” for FIFO and weighted average inventory costing methods
 - ▶ LIFO is scoped out
 - ▶ Effective for years beginning after 15 December 2016
 - ▶ Early adoption is permitted
- ▶ Entities that use LIFO must continue to follow the “lower of cost or market” approach
 - ▶ AICPA LIFO issues paper still governs the accounting for LIFO inventory
 - ▶ Lower of cost or market adjustments are reversed as affected inventory is sold

Additional resources

To the Point, *FASB simplifies the subsequent measurement of inventory* (SCORE No. BB3019)

Inventory

Lower of cost or market (or NRV): other considerations

- ▶ Consider adjustments for firm purchase commitments
- ▶ Hedging considerations
 - ▶ Inventory subject to fair value hedges still requires consideration and recognition of inventory impairment before considering the hedge
 - ▶ Cash flow hedges on inventory purchases or sales may result in amounts deferred in AOCI being realized into income:
 - ▶ When an impairment of inventory is recognized
 - ▶ When a forecasted future transaction becomes probable of not occurring
 - ▶ If a forecasted future transaction is possible, but no longer probable, hedge accounting is discontinued, but amounts remain deferred in AOCI

Additional resources

Financial reporting developments, *Derivatives and hedging* (SCORE No. BB0977), section 6.13.3, Impairment considerations

Oil and gas properties and related reserves

Impairment considerations

- ▶ Entities should consider whether recent and ongoing changes may be impairment indicators, such as:
 - ▶ Changes to pricing forecasts
 - ▶ Changes in drilling plans that may lead to leasehold expirations
 - ▶ Changes in field development that may suggest impairment of fixed assets, such as gathering systems in uneconomic areas
 - ▶ Counterparty credit declines for significant customers
 - ▶ Changes in the availability of financing that affect the ability to complete capital projects or commence operations timely

Additional resources

Financial reporting developments

Impairment or disposal of long-lived assets (SCORE No. BB1887)
including section 5.2, Oil and gas

Intangibles—Goodwill and other (SCORE No. BB1499)

Fair value measurement (SCORE No. BB1462)

Oil and gas properties and related reserves

Impairment considerations (cont.)

- ▶ These indicators may affect:
 - ▶ Proved oil and gas properties
 - ▶ Unproved properties
 - ▶ Other long-lived assets (e.g., gathering systems)
 - ▶ Goodwill
 - ▶ Inventory (especially for those with LIFO reserve adjustments)
- ▶ Full cost entities could have ceiling test write downs in multiple interim periods, especially if they had a write-down at year end

Additional resources

Financial reporting developments

Impairment or disposal of long-lived assets (SCORE No. BB1887)
including section 5.2, Oil and gas

Intangibles—Goodwill and other (SCORE No. BB1499)

Fair value measurement (SCORE No. BB1462)

including section IA.6, Fair value measurement considerations
for the oil and gas industry

EY Form 365US, *Prospective financial information (PFI) testing memo template*

Oil and gas properties and related reserves

Reserves – Proved reserves

- ▶ The continued decline in oil prices after year end are resulting in a historical 12-month average price that is lower, which may cause certain reserves to no longer be economic
- ▶ This could be an indicator for the need for revision
- ▶ Proved undeveloped reserves may require revision if there are changes in the drilling plans, economics or capital budgets
 - ▶ We understand that the SEC staff expects the criterion of “reasonable certainty” to apply to the geological attributes, management’s final investment decision, and the financing of development activities

Asset retirement obligations

Revisions to timing and amounts of estimated cash flows

- ▶ Changes in oil prices may lead to revisions of expected cash flows in ARO estimates
 - ▶ Lower prices may affect estimates of when wells will be plugged and abandoned, which could change the estimated timing (or probabilities associated with the timing) of plugging and abandonment (P&A) activities
 - ▶ Corresponding pressures to lower costs of service activities may lead to revisions of estimates of costs of P&A
- ▶ Entities should consider whether any revisions to ARO estimates are appropriate, as cost changes may affect different periods
 - ▶ For example, near-term cost pressures may lower the expected costs of P&A for wells that are nearing the end of life, while views of longer term recoveries in prices may mean cost assumptions in more distant years are more stable (this is just an example)
 - ▶ Consider corroborating or contrary information

Additional resources

Financial reporting developments, *Asset retirement obligations* (SCORE No. BB1026)
including section 5.2, Changes in estimates

Asset retirement obligations

Revisions to timing and amounts of estimated cash flows

- ▶ Entities also may experience changes to the uncertainty of the timing and amount of cash flows, which may affect probabilities assigned to expected cash flow scenarios or the market risk premium
- ▶ If revisions occur, remember to follow specific accounting guidance to determine the appropriate discount rate to apply
- ▶ Entities that use the full cost method also should ensure that estimates of retirement costs used in the full cost ceiling test are consistent with changes to ARO assumptions

Additional resources

Financial reporting developments, *Asset retirement obligations* (SCORE No. BB1026)
including Appendix B, Considerations for oil and gas producing entities

Income taxes

- ▶ Entities with interim reporting requirements may need to consider the effects on intraperiod tax allocations
- ▶ Valuation allowances on deferred tax assets, such as net operating loss carryforwards
- ▶ Indefinite reinvestment assertion
 - ▶ Liquidity risks may put pressure on management to repatriate earnings to fund operations
- ▶ Impairments and other non-cash adjustments
 - ▶ Entities should also consider the tax implications of impairments and whether they are “discrete” or “non-discrete” items when estimating the annual effective rate

Additional resources

Financial reporting developments, *Income taxes* (SCORE No. BB1150)
including Chapter 6, Valuation allowances,
Section 4.2, Investments in foreign subsidiaries
Chapter 15, Intraperiod tax allocation

Subsequent events

- ▶ Entities must consider the period subsequent to the balance sheet date until the financial statements are issued or available to be issued
 - ▶ Information that becomes available may suggest that a condition existed prior to the balance sheet date that should be considered
 - ▶ For example, a bankruptcy of a counterparty that occurs immediately after year end may suggest conditions existed at year end that should be considered in evaluating the allowance for doubtful accounts
 - ▶ Even if reported amounts should not change (i.e., the event represents a non-recognized subsequent event), additional disclosures may be required
 - ▶ For example, the subsequent sale of a significant asset for a loss that occurs after year end (though the entity may challenge its impairment analysis)
 - ▶ Special considerations may apply for specific accounting topics
 - ▶ For example, oil and gas guidance is specific about how to consider subsequent events for an exploratory well that is determined to be a dry hole

Reporting considerations

SEC staff comments on low oil prices

- ▶ Low oil prices (December 2014 AICPA conference)
 - ▶ MD&A trends and uncertainties
 - ▶ Risks and uncertainties
 - ▶ Emphasis on final investment decision for recognizing proved undeveloped reserves (PUDs)
- ▶ Examples of these comments are in the Appendix

Reporting considerations

Other reporting considerations

- ▶ Liquidity disclosure requirements and risk factors related to liquidity
- ▶ SEC staff may ask entities to provide information on:
 - ▶ The sensitivity of analyses to changes in pricing assumptions and the potential for future adjustments (e.g., impairments and full cost ceiling test adjustments)
 - ▶ Dependencies of drilling plans used for reserve estimates on expected price increases, and the effect if expected price increases do not occur
- ▶ Internal control over financial reporting
 - ▶ Potential for unusual or non-routine or estimation processes that may need to be evaluated
 - ▶ Sensitivity of controls in light of current environment

Today's agenda – Accounting Hot Topics

- ▶ Low oil prices – Accounting considerations
- ▶ FASB update
- ▶ SEC/PCAOB update

Selected FASB projects

Current status

Project	Status
Leases	Drafting final standard
Financial instruments	
Classification and measurement	Drafting final standard
Impairment	
Hedging	Drafting proposed ASU
Simplifying the accounting for measurement-period adjustments	Issued 25 Sept. 2015
Balance sheet classification of debt	Drafting proposed ASU
Clarifying the definition of a business	Drafting proposed ASU
Disclosure Framework	EDs issued

Leases



Leases project

Scope and definition of a lease

- ▶ The new standard would apply to leases of all assets except:
 - ▶ Leases to explore for or use natural resources.
 - ▶ This scope exception includes rights to use the land in which the natural resources are contained. However, leases of equipment used to explore for natural resources (e.g., drilling equipment) are not part of the exception.
- ▶ A contract would be a lease if it both:
 - ▶ Depends on the use of an identified asset (explicitly or implicitly)
 - ▶ No identified asset if the supplier has a substantive substitution right
 - ▶ Conveys the right to control the use of an identified asset – that is, the customer would have the right to:
 - ▶ Direct the use of the identified asset (i.e., direct how and for what purpose the asset is used throughout the period of use) **and**
 - ▶ Obtain substantially all of the potential economic benefits from directing the use

Determining when a customer has the right to direct the use of an identified asset may require judgment, particularly for arrangements that include significant services.

Leases project

Lease classification

- ▶ Lessees and lessors would classify leases using a classification principle similar to IAS 17, *Leases*
 - ▶ Similar to current US GAAP but without bright lines
 - ▶ Today's real estate-specific guidance would be eliminated

- ▶ Lessees would classify most leases as either:
 - ▶ Type A – similar to today's capital leases
 - ▶ Type B – similar to today's operating leases
 - ▶ For leases with a lease term of 12 months or less, lessees can make an accounting policy election to use short-term lease exemption
 - ▶ Not recognize lease assets or liabilities
 - ▶ Recognize lease expense on a straight-line basis

Leases project

Lessee accounting – recognition and measurement

	Type A lease	Type B lease
Initial recognition and measurement	Initially measure the right-of-use asset ¹ (ROU) and lease liability at the present value of the lease payments	
Subsequent measurement – lease liability	Accrete the lease liability based on the interest method using discount rate determined at lease commencement ² and reduce the lease liability by the payments made	Measure the lease liability at the present value of remaining lease payments using discount rate determined at lease commencement ²
Subsequent measurement – ROU asset	Amortize the ROU asset, generally on a straight-line basis over shorter of lease term or useful life of ROU asset	Measure ROU asset at amount of lease liability and adjust for cumulative prepaid or accrued rents (i.e., non-straight-line rent payments), any lease incentives received and lessee initial direct costs
Income statement effect	<ul style="list-style-type: none"> ▶ Generally “front-loaded” expense ▶ Separate interest and amortization 	<ul style="list-style-type: none"> ▶ Generally straight-line expense ▶ Single line of lease or rent expense

¹ Initial measurement of the ROU asset would also include the lessee’s initial direct costs and prepayments made to the lessor less lease incentives received from the lessor.

² As long as a reassessment and a change in the discount rate has not occurred.

Leases project

Lessee accounting – presentation

Balance sheet	Income statement	Statement of cash flows
<p>Type A lease ROU asset:</p> <ul style="list-style-type: none"> ▶ Separately from other assets (e.g., owned assets) or with corresponding underlying assets and disclose line items containing ROU assets and amounts <p>Type B lease ROU asset:</p> <ul style="list-style-type: none"> ▶ Separately from Type A lease ROU assets and disclose line items <p>Type A lease liability:</p> <ul style="list-style-type: none"> ▶ Separately from other liabilities or together with other liabilities and disclose line items containing lease liabilities and amounts <p>Type B lease liability:</p> <ul style="list-style-type: none"> ▶ Separately from Type A lease liabilities 	<p>Type A lease:</p> <ul style="list-style-type: none"> ▶ Amortization and interest expense not combined ▶ Present separately or disclose lease-related amortization and interest expense <p>Type B lease:</p> <ul style="list-style-type: none"> ▶ Single line item of lease or rent expense 	<p>Type A lease:</p> <ul style="list-style-type: none"> ▶ Principal payments within financing activities ▶ Interest payments within operating activities <p>Type B lease:</p> <ul style="list-style-type: none"> ▶ Payments within operating activities, except to the extent that they represent costs to bring another asset to the condition and location necessary for its intended use, which should be classified within investing activities. <p>Both lease types:</p> <ul style="list-style-type: none"> ▶ Lease payments for short-term leases and variable lease payments (not part of liability) within operating activities ▶ Supplemental non-cash disclosure of new leases

Leases project

Oil and gas considerations

- ▶ Drilling contracts
 - ▶ Bifurcation of lease and service components
 - ▶ Interactions with joint interest accounting
- ▶ Rights of way
- ▶ “First mile / last mile” infrastructure (e.g., well connections)

Hedging



Hedging model improvements

Overview

Goal: Make hedge accounting easier to apply and understand

- ▶ Why is the FASB making targeted improvements?
 - ▶ Reduce complexity when applying hedge accounting
 - ▶ Provide financial statement users with better insight into hedging strategies and their effectiveness
- ▶ What's staying the same?
 - ▶ Types of hedges
 - ▶ “Highly effective” threshold
 - ▶ Requirement to have contemporaneous documentation
 - ▶ Qualitative methods of assessing effectiveness (i.e., shortcut and critical terms match)

Hedging model improvements

Key tentative decisions

Issue	Current GAAP	Tentative decision
Recognition of ineffectiveness for cash flow hedges	Recognize in earnings	Record in accumulated other comprehensive income (AOCI)
Nonfinancial hedges (e.g., inventory)	Requires hedge of total price risk (purchase price)	May hedge contractually specified components
Quantitative effectiveness assessments	<ul style="list-style-type: none">▶ At designation▶ Quarterly thereafter	<ul style="list-style-type: none">▶ By end of quarter of designation▶ Subsequent assessments not required unless facts and circumstances change

Business combinations – measurement-period adjustments

- ▶ Changes to provisional amounts based on new information about facts that existed at acquisition date

Current GAAP	Tentative decision
<ul style="list-style-type: none"> ▶ Retrospectively adjust all comparative prior periods 	<ul style="list-style-type: none"> ▶ Recognize in period adjustment is identified

- ▶ Present or disclose amounts related to prior periods by line item (e.g., amortization)
- ▶ No changes to measurement period criteria or length

Effective dates for calendar year ends			
Transition method	PBE	Non-PBE	Early adoption?
Prospective	2016	2017	Yes

Definition of a business

Tentative decisions

- ▶ Definition interpreted broadly
- ▶ Used in several areas (e.g., consolidation, dispositions)
- ▶ Significant due to differences in accounting for assets versus businesses

Current definition	Tentative decision
Requires inputs and processes	Requires inputs and one or more substantive process
Outputs defined broadly as ability to provide a return	Narrows definition to focus on revenue
Does not matter if all value is attributable to a single asset	Requires evaluation of threshold (e.g., if substantially all of the value transferred relates to a single asset, it is an asset acquisition)

Definition of a business

What to watch for – oil and gas

- ▶ Judgmental areas to consider in the exposure draft
 - ▶ Where in the spectrum from exploration rights to producing properties is the line drawn to distinguish between an asset and business?
 - ▶ How would the guidance help evaluate whether a package of diverse properties in various stage of development should be accounted for as an asset or a business?
 - ▶ Is a pipeline a business or an asset?

Standard setting update

Disclosure framework

- ▶ Entity's decision process – Two EDs issued
 - ▶ Clarify the definition of materiality that appears in Concepts Statement 8 to focus on its nature as a legal concept
 - ▶ Clarify in each Topic that disclosure is required only if material
 - ▶ Remove language from current guidance in ASC topical disclosure sections that limits the use of discretion (e.g., “an entity shall at a minimum provide”)
 - ▶ Amend ASC 235, *Notes to Financial Statements*, to provide new limited guidance on applying materiality to note disclosures
 - ▶ Apply materiality to disclosures individually and in the aggregate
 - ▶ State that materiality is a legal concept

Standard setting update

Disclosure framework (cont'd)

- ▶ Topic-specific disclosure reviews
 - ▶ Defined benefit plans - ED is expected in Q4 2015
 - ▶ Fair value measurement – some tentative decisions; more research needed
 - ▶ Income taxes – some tentative decisions; more research needed
 - ▶ Inventory – no tentative decisions
 - ▶ Interim reporting – tentative decision made; more research needed

Today's agenda – Accounting Hot Topics

- ▶ Low oil prices – Accounting considerations
- ▶ FASB update
- ▶ SEC/PCAOB update

Selected SEC/PCAOB projects

Current status

Project	Status
Pay ratio disclosure - SEC	Final rule
Audit Committee disclosures – SEC	Considering feedback on concept release
Auditor's reporting model - PCAOB	Drafting reproposal
Auditing estimates including fair value measurements – PCAOB	Considering feedback on consultation papers
Use of specialists - PCAOB	
Audit quality indicators - PCAOB	Concept release comment period
Going concern - PCAOB	Drafting consultation paper

Pay ratio disclosure

SEC final rule

$$\text{Pay ratio} = \frac{\text{Annual total compensation of principal executive officer (PEO)}}{\text{Median annual total compensation of all other employees except PEO}}$$

- ▶ Allows some flexibility in determining median employee
 - ▶ Use entire population of employees or a statistical sample
 - ▶ Use any consistently applied compensation measure (e.g., W-2 information)
 - ▶ Generally calculate median employee every three years and make the determination at any point during the last three months of the fiscal year

Calendar year end entities provide 2017 ratio in 2018 proxy

Pay ratio disclosure

SEC final rule (continued)

Must include	May exclude
<ul style="list-style-type: none">▶ Employees of parent and consolidated subsidiaries▶ Part-time, seasonal and temporary employees	<ul style="list-style-type: none">▶ Independent contractors if paid by a third party▶ <i>De minimis</i> population of non-US employees in foreign jurisdictions (<5% of total employees)▶ Employees in foreign jurisdictions with data privacy laws (count towards <i>de minimis</i> exemption)

- ▶ Disclose the methods and material assumptions used in determining components of the pay ratio

Audit transparency initiatives

SEC concept release – audit committee disclosures

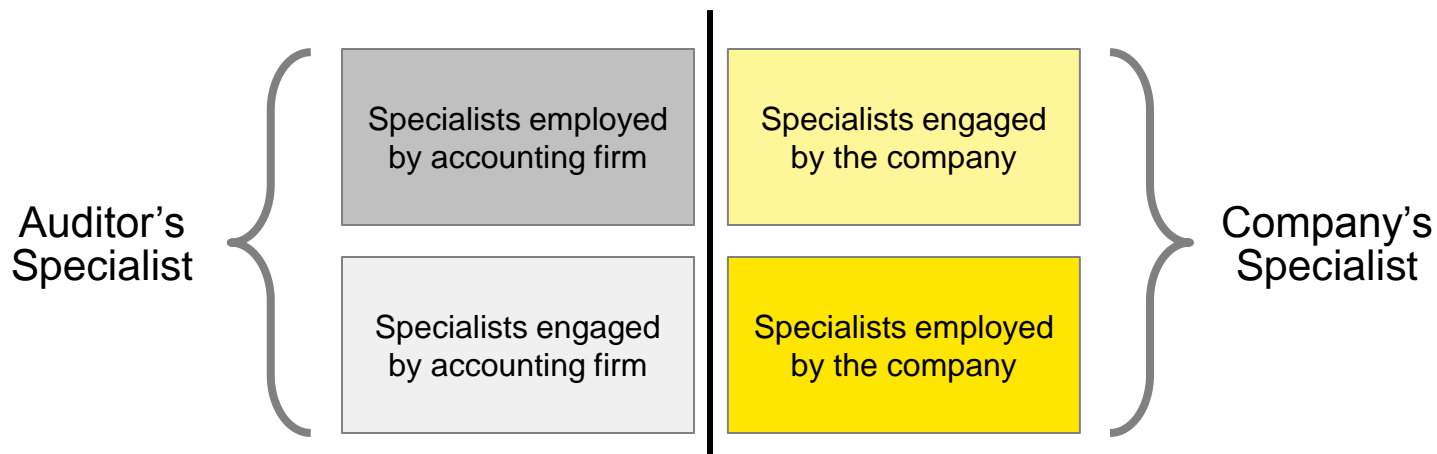
- ▶ Asks for feedback on whether more disclosures would benefit investors:
 - ▶ Explain how audit committees perform their responsibilities
 - ▶ Inform investment and voting decisions on ratification of auditor and re-election of audit committee members
- ▶ Explores possible changes to audit committee disclosures related to:
 - ▶ Oversight of the auditor
 - ▶ Process for appointing or retaining auditor
 - ▶ Evaluation of audit firm and engagement team qualifications

Comment period ended on 8 September 2015

Regulatory update

PCAOB outreach on use of specialists (e.g., reserve engineers)

- ▶ The PCAOB is considering existing guidance on the use of specialists to consider the risks posed by different models
 - ▶ Considered in Staff Consultation Paper 2015-01 from May 2015
 - ▶ PCAOB consultation paper considers if different risk exists for the auditor's specialists and the company's specialist
 - ▶ In addition to other uses of specialists, oil and gas entities frequently engage internal or external reserve engineers to evaluate oil and gas reserves



Audit transparency initiatives

PCAOB concept release – audit quality indicators (AQIs)

- ▶ Seeks comment on 28 possible AQIs
 - ▶ How could they be used by audit committees, audit firms, investors, and regulators?
 - ▶ Would other information be more useful?
 - ▶ How could they be distributed?
 - ▶ Should providing AQIs be voluntary?
- ▶ AQIs could help audit committees in their discussions with auditors to improve audit quality
 - ▶ Also could increase focus on quality in competition for audit services

Comments are due by 29 September 2015

Audit transparency initiatives

PCAOB concept release – audit quality indicators (continued)

	Category	Example
Professionals	<ul style="list-style-type: none">▶ Availability▶ Competence▶ Focus	Workload (e.g., chargeable hours and number of clients)
Process	<ul style="list-style-type: none">▶ Tone at the top▶ Incentives▶ Independence▶ Infrastructure▶ Monitoring and remediation	Results of monitoring and remediating quality issues (e.g., percentage of audits subjected to internal inspections and nature of findings)
Results	<ul style="list-style-type: none">▶ Financial statements▶ Internal control▶ Going concern reporting▶ Communications with audit committee▶ Enforcement and litigation	Restatements for errors (e.g., annual number and percentage, and magnitude of those restatements)

Appendix – Example SEC staff comments



SEC staff comment letter examples

Low oil prices: MD&A trend/uncertainty

- ▶ We are only beginning to see the comment letter activity after those speeches, but are providing some examples of comments we have seen

We note you evaluate upstream projects using a specific commodity price, while testing those projects for resilience at a lower price. Please describe the process through which upstream projects are tested for resilience and explain how the results impacted your estimates of proved reserves. As part of your response, please tell us how recent declines in commodity prices were a factor in this testing process. In addition, tell us whether the pattern of volatility in commodity prices discussed in your filing represents a trend or uncertainty which management considers reasonably likely to have a material effect on the recoverability of your proved reserves.

SEC staff comment letter examples

Low oil prices: PUD recognition

- ▶ We are only beginning to see the comment letter activity after those speeches, but are providing some examples of comments we have seen

In the Outlook section, you disclose significant reductions in rig counts and capital expenditures compared to the prior year. However, it appears that you did not remove any PUD volumes as a result of these reductions. Tell us the extent to which your disclosed PUD volumes at year end include quantities that were delayed, deferred or rescheduled as a result of planned reductions in capital spending and development activities. Additionally, tell us the pricing assumptions used in developing your PUD development schedule.

SEC staff comment letter examples

Low oil prices: Risk factor disclosures

Your risk factor disclosures indicate that continued lower prices for oil and natural gas could have an impact on your liquidity, financial condition and results of operations. Separately, you disclose reductions in your development activities and capital expenditures. Finally, remarks from your CFO from a recent earnings call describe plans you have developed under different pricing scenarios and the potential impacts of different prices.

Revise your risk factor disclosure to provide additional language about the risks from the uncertainty associated with recent changes in commodity prices, including quantitative disclosure regarding your reserve quantities reflecting potential scenarios deemed reasonably likely to occur by management. Your revised disclosure should also address the possibility of impairment of your oil and gas properties if lower commodity prices continue.

SEC staff comment letter examples

Reserves: PUDs and lease expiration

You disclose that leases covering approximately XX% of your gross undeveloped acreage will expire over the next three years. Please tell us the extent to which you have assigned any proved undeveloped reserves as of December 31, 2013 to locations which are currently scheduled to be drilled after lease expiration. If your proved undeveloped reserves include any such locations, please expand your disclosure to explain the steps which would be necessary to extend your legal right to these leases and to address whether you would have a legal right to produce reserves from this acreage. Refer to Rule 4-10(a)(26) of Regulation S-X.

SEC staff comment letter examples

Reserves: Disclosures and reconciliation of material changes in PUDs

Please expand your disclosure to include a narrative explanation for the material changes in your proved undeveloped reserves such as the change relating to the line item entry ``additional PUDs added`` in the table on page XX. Refer to Item 1203(b) of Regulation S-K.

We note that you supplementally submitted a reconciliation of the changes in your proved undeveloped reserves that occurred during 2013. We also note the XX MMBoe change in your gas reserves appears to be the result of two separate causal factors (e.g., extensions and discoveries relating to your drilling and revisions relating to an increase in gas pricing). We believe disclosure regarding each of the causes for material changes in your proved undeveloped reserves should be provided under Item 1203(d) of Regulation S-K. Accordingly, please expand your disclosure to provide the change in net quantities and an explanation of such changes sufficient to reconcile the overall change in your proved undeveloped reserves.

SEC staff comment letter examples

Reserves: Capital expenditures toward PUD conversion

Please expand your disclosure to present the total dollar amounts of capital expenditures made during the year to convert proved undeveloped reserves to proved developed reserves. Refer to the disclosure requirements set forth in Item 1203(c) of Regulation S-K.

SEC staff comment letter examples

Reserves: PUD conversion rate / 5-year rule

It appears the 2013 proved undeveloped reserves development rate is [less than 20%]. Based on disclosure in the Forms 10-K for the 2012 and 2011 fiscal years, it appears the proved undeveloped reserves development for 2012 and 2011 are [less than 20%] each.

This cumulative conversion of [less than 50%] over three years does not indicate that your PUD development activities will comply with the requirements of Rule 4-10(a)(31) of Regulation S-X, i.e. `` (ii) Undrilled locations can be classified as having [proved] undeveloped reserves only if a development plan has been adopted indicating that they are scheduled to be drilled within five years, unless the specific circumstances, justify a longer time. ``

Please explain to us the reasons that your PUD conversion rates do not appear to follow a five year development schedule that complies with Regulation S-X.

SEC staff comment letter examples

Reserves: PUDs with negative “PV10”

You clarified there were XX proved undeveloped locations totaling XX Bcf that were associated with a negative present worth when discounted at 10 percent. Based on the disclosure of your proved reserves provided in the 2013 Form 10-K, we note the XX Bcf attributable to these locations represents approximately XX% of your total proved undeveloped reserves of XX Bcfe and XX% of your total proved reserves of XX Bcfe. To the extent that the Company determines that the reserves associated with locations that have negative present worth discounted at 10% comprise a material portion of the Company’s total proved reserves, please expand your disclosure regarding such locations in your annual filing on Form 10-K to address the following:

- Clarify that reported reserve volumes include locations and quantities that have a negative present value when discounted at 10%;
- Indicate the number of locations and reserve volumes with a negative present value, and;
- Confirm that you have made a final investment decision, and are committed to developing the reserves, despite the negative value.

SEC staff comment letter examples

Reserves: Final investment decision

Please refer to Question 131.04 in the SEC Compliance and Disclosure Interpretations (C&DIs), issued October 26, 2009 and updated May 16, 2013, and affirm management is committed to drilling all such proved undeveloped locations. Please tell us the extent to which there are any proved undeveloped reserves as of December 31, 2013 which do not have an adopted development plan and final investment decision. You may find the C&DIs on our website at the following address: <http://www.sec.gov/divisions/corpfin/guidance/oilandgas-interp.htm>.