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Director, TA&I-FSP Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

### Proposed FASB Staff Position FAS 19-a, Accounting for Suspended Well Costs

We appreciate the opportunity to comment on the proposed FASB Staff Position FAS 19-a, Accounting for Suspended Well Costs (the FSP). We support the issuance of the FSP as we believe that it amends FASB Statement No. 19, Financial Accounting and Reporting by Oil and Gas Producing Companies (Statement 19), such that the concepts included therein are more reflective of the facts and circumstances applicable to exploration activities conducted by many oil and gas companies in today's business environment. However, we have certain comments regarding the FSP, which are presented below.

#### **Disclosures**

We agree that the objective of the disclosures required by the FSP should be to provide users of the financial statements with information regarding management's evaluation and plans relating to capitalized exploratory well costs. We believe that users of the financial statements will be primarily concerned with the risk that the costs of suspended exploratory wells (particularly those that have been suspended for a period greater than one year) will ultimately be expensed by the reporting enterprise because of an inability to classify the associated reserves as proved. We believe that the reconciliation of suspended well costs from period to period required by paragraph 10(a) of the proposed FSP does not directly address this, and that the other required disclosures will provide users of the financial statements sufficient information relating to this risk. Accordingly, we do not support including the requirement to reconcile suspended well costs from period to period in the final FSP.

We do not support the requirement to include disclosure of the number of wells to which suspended exploratory well costs relate as part of the financial statements. Historically, such information has not been included in financial statements as the number of wells maintained by an oil and gas company is not always obvious. For instance, if a company decides to explore a deeper horizon by utilizing an existing wellbore, the costs to extend the existing wellbore will be

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considered exploratory drilling costs. However, it is unclear whether the company's number of wells should consider the existing wellbore and the extension to be one well or two. Additionally, the number of wells may not be directly derived from accounting systems and, as such, may not be subject to the internal control systems generally applied to the information contained in financial statements.<sup>1</sup>

If the Board believes that the number of wells to which suspended exploratory well costs relate is meaningful information that should be reported, we believe that it should be presented as supplementary information, consistent with the presentation of the information required by paragraphs 10-34 of FASB Statement No. 69, Disclosures about Oil and Gas Producing Activities, an amendment of FASB Statements 19, 25, 33, and 39. Additionally, we believe that the FSP should clarify that the number of wells reported should be gross wells, determined in a manner consistent with the provisions of SEC Exchange Act Guide 2, Disclosure of Oil and Gas Operations.

The example disclosure included in the FSP uses the terms "well" and "project." We are unsure if these terms are intended to refer to suspended exploratory wells interchangeably, or if the use of the term project is intended to denote that there are additional activities associated with the drilling activities undertaken by the reporting enterprise that may also require disclosure. The example disclosure should be modified to clarify this point.

### **Transition**

Paragraph 11 of the FSP states that "(a)ny capitalized exploratory well costs that are expensed upon the application of this guidance shall be recognized in income from continuing operations...."

We believe that the amendments to paragraphs 31-34 of Statement 19 included in the FSP eliminate any confusion as to whether the capitalization of suspended well costs for any period exceeding one year is appropriate when additional exploratory drilling is not under way or firmly planned to occur. If an exploratory well had discovered commercially producible quantities of reserves, many financial statement preparers and auditors had previously interpreted Statement 19 to permit the capitalization of the well costs for a period exceeding one year without requiring additional exploratory drilling, as long as future capital expenditures necessary to produce the

<sup>&</sup>lt;sup>1</sup> Because of these reasons, we have traditionally refused to comment on the number of wells reported by oil and gas companies outside of the financial statements in letters provided to underwriters pursuant to AICPA Statement of Auditing Standard No. 72, Letters for Underwriters and Certain Other Requesting Parties, as amended.

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reserves were being assessed, or if such assessment had been completed, appropriate progress was being made against the determined plan for the production of the reserves. We believe that this interpretation, and the methods by which it was applied in practice, are consistent with the proposed changes to Statement 19 included in the FSP.

Accordingly, we believe that if upon adoption of the FSP a determination is reached that previously suspended exploratory well costs should be expensed, that determination should be accounted for through retroactive application of the provisions of the FSP pursuant to Accounting Principles Board Opinion No. 20, Types of Accounting Changes. As proposed by the FSP, however, the capitalization of exploratory well costs previously expensed should not be permitted.

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We would be pleased to discuss the above with you, the Board members, or other staff at your convenience.

Very truly yours,

Ernet + Young LLP