



Omega College



March 7, 2005

Letter of Comment No: 2
File Reference: FSPFAS19A

The Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Dear Sir/Madam:

Re: FSP FAS 19-a Accounting For Suspended Well Costs

A group of Undergraduate Accounting Majors enrolled at Omega College, Nassau Bahamas, ACCT 324, was given an assignment for Accounting Theory. The assignment required students' comments on the proposed FSP FAS 19-a on Suspended Well Costs. The comments below represent the position of the Accounting Theory Class of Omega College, and not necessarily that of other students, lecturers, and staff of Omega College.

The FASB recently issued a proposed FASB staff position FSP FAS 19-a on accounting for suspended well costs that will allow companies to continue to capitalize certain costs associated with exploring for new oil or gas reserves, while requiring further disclosure of such costs.

We begin by stating that we agree with FSP FAS 19-a, as we accept that the suspended well cost is an asset, as it meets the definition of an asset as stated in SFAC#6 paragraph 25; "Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." The position also meets the recognition requirements as laid out in SFAC#5 paragraph 63 which states; an item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are met, subject to a cost-benefit constraint and a materiality threshold.

Those criteria are:

Definitions – the item meets the definition of an element of financial statements.

Measurability – it has a relevant attribute measurable with sufficient reliability.

Relevance – the information about it is capable of making a difference in user decisions.

Reliability – the information is representationally faithful, verifiable, and neutral.

In addition SFAC #5 states that expenses are recognized when there has been a consumption of economic benefits or a loss of future economic benefits. We can not say with any degree of certainty that the economic benefits derived from the Suspended Well Costs will be consumed within the one year time frame. SFAC #5 paragraphs 88 and 89 go on to say that once an asset is recognized it continues to be measured at the amount initially recognized until an event changes it or its amount occurs and meets the recognition criteria. There are two types of events that change assets (a) inflows and outflows or (b) changes in the amounts of assets while held by the entity. The Suspended Well Costs don't meet these criteria to be expensed.

Furthermore, SFAC #6 paragraph 33 states that an asset continues as an asset of the entity until all future benefit is either used up or removed from the entity's ability to obtain it. We feel that the entity will continue to have the economic benefit of the Suspended Well Cost after the one year time limit thus expensing these cost would be an error.

The process of accounting prescribed by FASB Statement No. 19 necessitates that the costs of drilling exploratory wells and certain other wells be capitalized until a determination of whether the well has found proved reserves. If proved reserves are not established, the capitalized costs are then charged to expenses. The time period allotted to make the determination is generally limited to one year.

However, since Statement No. 19 was issued in 1977, there have been important changes in the drilling of wells, such as drilling to greater depths and in more remote areas. Therefore, it is more complicated and sometimes impossible for organizations to make the determination about proved reserves in the time allotted by FASB statement No.19. It is for these reasons that we believe it is acceptable to continue to capitalize the suspended well costs beyond the one year time frame.

The guidelines for determining whether an enterprise is making sufficient progress assessing the reserves and the economic and operating viability of the project is detailed in the statement. It also specifies that since the guidance permits additional judgment than FASB 19 additional disclosures are also required. This aspect of the proposed statement would ensure that all progress is evaluated on the same standard set of criteria.

One concern is the lack of a time frame allotted for the assessment of the reserves and the completion of the well. Although the staff guidance states that capitalization of drilling costs should not continue 'on the chance that' (a) event(s) will occur that is outside the enterprise's control (for example, an increase in the market price of oil or gas or

(b) technology will be developed to make the development of the well economically and operationally viable, no definite time frame was set. This matter then leads to the valuation of the financial statements. How long do we capitalize the assets in the financials after the completion of the wells in an effort to prove reserves? At what point should a preparer begin to expense the cost after capitalizing it for such a period of time? This now brings us to the most important question of all... Does this make the financial statements misleading?

In conclusion, we support FSP FAS 19a proposal on Accounting for Suspended Well Cost. However, we encourage the committee to address these few concerns to add clarity and preciseness to the position.

Should you have any questions or queries on our response to your proposal, please contact us at:

(242) 324-8934 or omegaarc@batelnet.bs

Sincerely,

Accounting Theory Class
Omega College