



Ernst & Young LLP
5 Times Square
New York, NY 10036
Tel: +1 212 773 3000
www.ey.com

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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Proposed Accounting Standards Update, Oil and Gas Reserve Estimation and Disclosure
File Reference No. 1730-100

Dear Mr. Golden:

We appreciate the opportunity to comment on the Financial Accounting Standards Board's Proposed Accounting Standards Update, *Oil and Gas Reserve Estimation and Disclosures* (the Exposure Draft). We fully support the FASB's overall objective to align the oil and gas reserve estimation and disclosure requirements in *Extractive Industries - Oil and Gas* (Topic 932) with the requirements in the Securities and Exchange Commission's (SEC) final rule, *Modernization of Oil and Gas Reporting* (the Final Rule). The amendments in the Final Rule are designed to modernize and update oil and gas disclosure requirements to align them with current industry practices and changes in technology. We believe that aligning the definitions and reporting requirements of the SEC's Final Rule and the FASB's Topic 932 will provide consistent information to users of the financial statements. We encourage the Board to issue final guidance as soon as reasonably possible after the comment period to allow entities sufficient time to prepare for adoption of the amendments.

As described in the responses below to the specific questions posed in the Exposure Draft, we believe changes should be made to the Exposure Draft to clarify certain requirements involving equity-method investments and transition.

Do you agree with the Board's decision to amend Topic 932 to clarify that equity-method investments must be considered in determining whether an entity has significant oil and gas producing activities?

We agree that the Board should clarify that equity-method investments should be considered in determining whether an entity has significant oil and gas producing activities. Because many oil and gas companies enter into joint ventures and other partnerships as a means to spread the risk of and finance their exploration and production activities, we believe the effect of equity-method investments should be considered. However, we do not believe the Exposure Draft is clear in

specifying how companies should incorporate the effect of their equity-method investments in calculating the significance tests.

We believe there are several methods companies could use to incorporate the effect of their equity-method investments in the significance tests. One method would be to determine the pro-rata share of revenue, results of operations and identifiable assets of an entity's equity-method investments with oil and gas producing activities, as reported by the investee, and use those amounts in calculating each significance test. Another method would be to include equity income from equity-method investments in the results of operations test and the investment balance in the identifiable asset test. Because of the different methods an entity could use to include the effect of their equity-method investments in determining if an entity has significant oil and gas producing activities, inconsistency in disclosure practices could result if the Exposure Draft is not clarified.

We believe including the equity method income from equity-method investments in the results of operations test and the investment balance in the identifiable assets test is the preferable method of including the effect of equity-method investments in determining whether an entity has significant oil and gas producing activities. We believe using the pro-rata share of revenue, income and assets of an investee in the significance tests results in the use of a different basis than is reflected in the investor's financial statements (i.e., the amounts reported by the investee would not reflect the investor's basis difference resulting from the difference in the cost of the acquisition of the investment and the carrying value of the investor's proportionate interest in the investee's net assets). Conversely, the use of the equity method income and the related investment balance would appropriately include the effects of those basis differences. We believe the Board should make it clear in the definition of significant oil and gas producing activities how the effect of equity investments should be included in the calculation of the significance tests.

Do you agree with the Board's decision to require that an entity disclose the same level of detail about equity-method investments with significant oil and gas producing activities as it does for its consolidated subsidiaries? Should the Board consider establishing a threshold below which the entity would not be required to provide oil and gas disclosures about its equity-method investment with significant oil and gas producing activities? If so, what should be the basis for that threshold?

Additional disclosures are required if investments in common stock of corporate joint ventures or other investments accounted for under the equity method are, in the aggregate, material in relation to the financial position or results of operations of an investor. Those disclosures include summarized information as to assets, liabilities and results of operations of the investees. Because the overall results of operations of the investee may be presented elsewhere in the notes to the financial statements for material equity-method investments, we believe expanded disclosure of the quantity of reserves and the standardized measure for oil and gas reserves for equity-method investments may be informative to financial statement users.

The Board has proposed establishing that the expanded disclosure requirements are applicable only to equity-method investments with "significant" oil and gas producing activities. We believe that additional clarity should be provided to help preparers determine whether this significance

threshold is met. That is, it should be made clear whether significance of the investee's oil and gas producing activities should be determined in relation to the equity method investee's operations or the overall operations of the entity itself. The determination of significance could be very different depending on which approach an entity takes.

We believe the determination of whether an equity investment with oil and gas activities is significant should be based on the overall operations of the entity (i.e., investor) itself. If it is intended that significance be determined relative to the investee's operations (which seems to be suggested by a literal reading of the proposed requirement), then the proposed disclosure requirement may result in expanded disclosures for small equity-method investments with oil and gas producing activities that are only significant to the investee. For example, if oil and gas producing activities represent 50% of an equity investee's operations but the total equity investment in the investee represents only 5% of an entity's results of operations or assets then, under the Exposure Draft, the detailed oil and gas disclosures for the equity-method investment would be required in the unaudited supplemental oil and gas disclosures. While this may not be the Board's intent, we believe that requiring significance to be determined based on the investee's operations could result in extensive disclosures that may not be representative of the significant oil and gas operations of the entity.

Some preparers have expressed concerns regarding obtaining the level of detail required from their equity method investees to complete the disclosures, especially as it relates to the capitalized costs and results of operations disclosures. Preparer concerns are centered on both the availability of information (e.g., not all investees have their upstream operations information disaggregated from their other operations) as well as timeliness. The Board should consider preparers' comments in this area and weigh the costs associated with providing the expanded disclosures, especially the capitalized costs and results of operations detail, for equity-method investments as compared to any benefits cited in users' comments. Clarification that significance should be determined at the entity level as discussed above may alleviate some of these preparer concerns.

Do you agree with the Board's decision to permit an entity to present a total of consolidated entity and the entity's share of equity method quantities of reserves and financial statement amounts?

While we are not strongly opposed to permitting an entity to present a combined total of consolidated and its share of equity method quantities of reserves and financial statement amounts, we question whether such a total is appropriate. For example, is it appropriate to include in the grand total of reserves the proportionate share of reserves of equity-method investees that are not controlled by the entity? While we don't think such a total is appropriate, if users' comments support the combined presentation, we would not oppose the practical accommodation of permitting that presentation as long as the disclosure is clear that the total includes amounts not under the entity's control.

Do you agree with the Board's decision not to require that an entity precisely measure and disclose the cumulative effect of every aspect of the adoption of the amendments to Topic 932 in this proposed Update on reserve quantities or the standardized measure for discounted future net cash flows?

We do not object to the Board's practical accommodation to not require an entity to precisely measure and disclose the cumulative effective of adoption for each of the required disclosures in ASC 932.

The Exposure Draft would require, if significant and practical to estimate, quantitative and qualitative disclosures regarding the effect of initially applying the amendments on the disclosures required in ASC 932. We presume that the Board has proposed a practical accommodation to not require the effect of adoption to be presented as a single line in each disclosure primarily because of the burden it would place on preparers to obtain two sets of reserve reports in the relatively short year-end reporting period in order to quantify the effect. As a result, we believe the Board should clarify whether the practicality exception in the transition requirements would require a preparer to look to the practicability criteria in ASC 250, *Accounting Changes and Error Corrections*. If it is the Board's intent for preparers to look to those criteria, we believe many might not meet that high threshold, and the Board's attempts to provide a practical accommodation may not be achieved. If it was not the intent of the Board for preparers to look to the practicability guidance in ASC 250, we believe the Board should provide guidance for determining the practicability of making the otherwise required estimate.

The Exposure Draft is not clear on whether qualitative disclosures are required when the quantitative disclosures are not significant or impractical to estimate. For example, some may conclude that even though the quantitative effect may be significant, if it is not practical to estimate, only a statement of that fact and why it is not practical to estimate is required. In this case, qualitative disclosure of the effect on the disclosures (e.g., "reserves significantly increased (decreased) as a result of the adoption of the ASU because...") would be useful information. We believe a qualitative discussion of the amendments and their effect should be included, if the effect is significant, whether or not quantitative information is provided.

Because the amendments represent a change in accounting estimate (inseparable from a change in accounting principle), companies would be required to disclose the effect of the change on their financial statements (e.g., the effect on depreciation, depletion and amortization). However, there is no practicability exception in ASC 250 with respect to this disclosure requirement. Therefore, preparers would be burdened with the task of quantifying the effect of adoption of the proposed ASU, which would require preparation of two reserve reports. If the Board intended the proposed practicability exception to allow preparers to avoid the expense of preparing two reserve reports, we believe the same accommodation is necessary with respect to the disclosures required by ASC 250.

Other comment areas

We also urge the Board to work with the Public Company Accounting Oversight Board to evaluate the effect of any changes to the Board's rules on auditing standards. For example, US Auditing Standards Section 9558, *Required Supplementary Information: Auditing Interpretations of Section*

558 (AU 9558), refers to “prices received at the end of the entity’s fiscal year.” We believe AU 9558 should be updated to be consistent with the amendments that will be made to Topic 932.

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We appreciate the opportunity to provide our comments and observations on the Exposure Draft and would be pleased to discuss them with the Board members or the FASB staff at your convenience.

Very truly yours,

Ernst & Young LLP