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Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

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

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Proposed Accounting Standards Update, *Oil and Gas Reserve Estimation and Disclosures (the "Exposure Draft")*.

The primary objective of the Exposure Draft is to align the oil and gas reserve estimation and disclosure requirements of Extractive Industries - Oil and Gas (Topic 932) with the requirements in the Securities and Exchange Commission's final rule, *Modernization of the Oil and Gas Reporting Requirements* (the "Final Rule"). We generally support this objective. However, we have a number of observations, which are described below.

Transition

While the Exposure Draft indicates that its various amendments should be treated as a "change in estimate," Section VII (B) of the Final Rule indicates that these same amendments should be treated as "a change in accounting principle that is inseparable from a change in accounting estimate." Based on the facts and circumstances, we believe the amendments in the Exposure Draft and in the Final Rule should be characterized as a change in accounting estimate. Further, given that Topic 250-10-50-4, Accounting Changes and Error Correction, requires the incremental disclosure described by paragraphs 250-10-50-1 through 50-3 to be made when an entity effects a change in estimate by changing an accounting



principle, we recommend that the transition section of the Exposure Draft be amended so it is clear that paragraphs 250-10-50-1 through 50-3 are not applicable.

Amendments to Master Glossary

The Final Rule amended the definition of "exploratory well," and for the first time defined the term "extension well." While undefined prior to the Final Rule, we believe that an extension well has always been considered a type of exploratory well. Further, based on our experience extension wells are accounted for as exploratory wells. Based on the proposed definitions of exploratory well and extension well in the Exposure Draft, it appears that an extension well is no longer an exploratory well and, accordingly, extension wells would be accounted for as development wells. Given that the Final Rule was limited to changing disclosures related to oil and gas activities, we believe that the new definitions of an exploratory well and an extension well were never intended to change the accounting for extension wells; a view confirmed by the staff of the SEC. Accordingly, we suggest the phrase "an extension well" be eliminated from the proposed definition of an exploratory well.

Future Development and Production Costs

The Final Rule is clear that entities should use the average, first-day-of-the-month price during the preceding 12-month period, rather than the year-end price, to determine proved reserve quantities that are economic to produce. It was silent, however, concerning the basis used to determine future development and production costs related to those proved reserves. Paragraph 932-235-50-31-b in the Exposure Draft indicates that future development and production costs should be estimated "at the end of the year, based on year end costs." Not only is a year-end convention for costs inconsistent with the 12-month average used for pricing, but it would eliminate the additional one month to prepare reserve disclosures that the SEC sought to give companies by moving to the first-of-the-month pricing convention. We believe that the notion of "existing economic conditions" included within the definition of proved oil and gas reserves (as included in the Master Glossary) is sufficient to determine how an entity should estimate future development and production costs. Accordingly, we recommend that the words "at the end of the year, based on year end costs and" be removed from 932-235-50-31-b.

Implications to the Auditing Standards

AU 9558.05(d) states that the auditor should make inquiries about the calculation of the standardized measure of discounted net cash flows, including whether the prices used to develop future cash inflows from estimated production of proved reserves are based on prices received at the end of the entity's fiscal year. Given that the Exposure Draft proposes amending Topic 932 to use a 12-month average price, the standardized measure would no longer be based on year-end prices. Therefore, we recommend that the FASB coordinate with the PCAOB to amend the procedures



prescribed in AU 9558.05(d) to reflect all pertinent changes to Topic 932, including those related to future development and production costs noted above.

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We appreciate the opportunity to express our views on the Exposure Draft. If you have any questions regarding our comments, please contact Ken Miller (973) 236-7336.

Sincerely,

PriceWaterhouseCoopers LLP

**APPENDIX
Response to Questions**

**Exposure Draft
Proposed Accounting Standards Update, Oil and Gas Reserve Estimation and
Disclosures**

1. 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? Please describe any challenges that would be encountered in meeting this requirement.

Response: We support the Board's decision to clarify that equity-method investments must be considered in determining whether an entity has significant oil and gas producing activities. As a result of this clarification, use of the term "significant oil and gas producing activities" in the scope of Topic 932 will be consistent with how it is used in the disclosure requirements of Topic 932.

2. 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? Please describe any challenges that would be encountered in meeting this additional requirement. 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 of that threshold?

Response: We note that larger oil and gas entities commonly own investments with significant oil and gas producing activities that are accounted for as equity method investments. Many times the business activities of an equity method investee are identical to the business activities of a consolidated subsidiary operating in the same geographic area. We also note a high degree of commercial interaction between the consolidated subsidiaries and the equity method investees. Given that the supplemental disclosures included in Topic 932 are intended to provide users with a more meaningful and comprehensive understanding of oil and gas reserves, we support the Board's decision to require an entity to disclose the same level of detail about equity method investments with significant oil and gas producing activities as it does for its consolidated subsidiaries. We can envision situations in which entities might encounter difficulties meeting this requirement for certain smaller investments.



Accordingly, we would support establishing a very low threshold below which the entity would not be required to provide oil and gas disclosures about an equity method investment with significant oil and gas producing activities. We recommend that such a threshold be applied to total enterprise proved reserves (i.e., the sum of consolidated and equity method volumes).

3. Should the Board consider permitting an entity to present the equity method investment quantity and amount detail in total rather than by geographic areas and product (if applicable)? See the appendix of this proposed Update for an example of this alternative presentation for reserve quantities.

Response: While we generally support the Board permitting an entity to present the equity method investment quantity and amount detail in total rather than by geographic areas and product, we found the table in the appendix to the Exposure Draft confusing on numerous points and incomplete in that it only considered Example 1 of the required disclosures from Topic 932. The examples included in Attachment B of the response to the Exposure Draft from the American Petroleum Institute address our concerns about the example from the appendix to the Exposure Draft.

4. 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? Does the total for the financial statement amounts provide decision-useful information even though it would not agree to the corresponding financial statement line items of the entity, since equity method investments are presented net within a single line item of the financial statements?

Response: As included in our response to question two, we note that larger oil and gas entities commonly own equity method investments with significant oil and gas producing activities which often are similar to, and integrated with, the operations of its consolidated subsidiaries. Further, we believe that the supplemental disclosures of proved reserve quantities and standardized measure of discounted future net cash flows required by Topic 932, while not derived directly from the basic financial statements, are considered fundamental by many users when evaluating oil and gas companies. In recognition of these points and the fact that oil and gas reserves from consolidated subsidiaries and equity method investees are recognized and measured on a consistent basis, we do not take exception with the Board's decision to permit entities to present a total of consolidated entity and its share of equity method amounts for these two supplemental disclosures. However, it is unclear to us if permitting an entity to present a total of consolidated entity and the entity's share of equity method for financial statement amounts results in useful information. While



such totals may be intuitive to some users given that the basic oil and gas accounting model included in Topic 932 is predicated on proportionate consolidation, sometimes the financial statement information from an equity method investee may not be comparable with the same financial statement information from consolidated subsidiaries. For example, SEC Staff Accounting Bulletin Topic 12C, Item 2, Question 2 does not require accounting method consistency between a registrant and its equity method investees in regard to the successful efforts method and the full cost method. Accordingly, if an equity method investee uses the full cost method of accounting as described in Rule 4-10(c) of Regulation S-X, it would be inappropriate to add the full cost financial statement amounts to financial statement amounts from consolidated subsidiaries that use the successful efforts method of accounting described in Topic 932.

5. The Board decided that if the effect is significant and practical to estimate, an entity should disclose the effect (or portions of the effect) of the amendments to Topic 932 in this proposed Update on individual line items of the “roll-forward” disclosures of reserve quantity and the standardized measure for discounted future net cash flows. 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? Please describe any operational or technical challenges with providing a “cumulative-effect” disclosure.

Response: We support the Board’s decision not to require entities to precisely measure and disclose the cumulative effect of every aspect of the amendments to Topic 932 in this Exposure Draft on reserve quantities or the standardized measure for discounted future net cash flows. Given the operational and technical challenges of calculating the cumulative effects of the various amendments proposed in the Exposure Draft, such as those demonstrated in the response to the Exposure Draft from the American Petroleum Institute, we are persuaded that calculating such cumulative effect disclosures is impracticable for most large entities. We believe the largest single impact of the amendments to Topic 932 on an industry-wide basis will most likely relate to the inclusion of resources that result in synthetic oil or gas. Given the required tabular format of Example 1 in the Exposure Draft, the cumulative effect of including resources that result in synthetic oil and gas will be separately disclosed.