

the nature, extent and impact of such assistance needs to be fully discussed in Management's Discussion and Analysis.³

Topic 12: Oil and Gas Producing Activities

A. Accounting Series Release 257—Requirements for Financial Accounting and Reporting Practices for Oil and Gas Producing Activities

1. Estimates of Quantities of Proved Reserves

Facts: Rule 4–10 contains definitions of proved reserves, proved developed reserves, and proved undeveloped reserves to be used in determining quantities of oil and gas reserves to be reported in filings with the Commission.

Question 1: The definition of proved reserves states that reservoirs are considered proved if “economic producibility is supported by either actual production or conclusive formation test.” May oil and gas reserves be considered proved if economic producibility is supported only by core analyses and/or electric or other log interpretations?

Interpretive Response: Economic producibility of estimated proved reserves can be supported to the satisfaction of the Office of Engineering if geological and engineering data demonstrate with reasonable certainty that those reserves can be recovered in future years under existing economic and operating conditions. The relative importance of the many pieces of geological and engineering data which should be evaluated when classifying reserves cannot be identified in advance. In certain instances, proved reserves may be assigned to reservoirs on the basis of a combination of electrical and other type logs and core analyses which indicate the reservoirs are analogous to similar reservoirs in the same field which are producing or have demonstrated the ability to produce on a formation test.

Question 2: In determining whether “proved undeveloped reserves” encompass acreage on which fluid injection (or other improved recovery technique) is contemplated, is it appropriate to distinguish between (i) fluid injection used for pressure maintenance during the early life of a

field and (ii) fluid injection used to effect secondary recovery when a field is in the late stages of depletion? The definition in Rule 4–10(a)(4) does not make this distinction between pressure maintenance activity and fluid injection undertaken for purposes of secondary recovery.

Interpretive Response: The Office of Engineering believes that the distinction identified in the above question may be appropriate in a few limited circumstances, such as in the case of certain fields in the North Sea. The staff will review estimates of proved reserves attributable to fluid injection in the light of the strength of the evidence presented by the registrant in support of a contention that enhanced recovery will be achieved.

Question 3: What volumes of natural gas liquids should be reported as net reserves, that portion recovered in a gas processing plant and allocated to the leasehold interest or the total recovered by a plant from net interest gas?

Interpretive Response: Companies should report reserves of natural gas liquids which are net to their leasehold interests, *i.e.*, that portion recovered in a processing plant and allocated to the leasehold interest. It may be appropriate in the case of natural gas liquids not clearly attributable to leasehold interests ownership to follow instructions to Item 3 of Securities Act Industry Guide 2 and report such reserves separately and describe the nature of the ownership.

Question 4: What pressure base should be used for reporting gas and production, 14.73 psia or the pressure base specified by the state?

Interpretive Response: The reporting instructions to the Department of Energy's Form EIA–28 specify that natural gas reserves are to be reported at 14.73 psia and 60 degrees F. There is no pressure base specified in Regulation S–X or S–K. At the present time the staff will not object to natural gas reserves and production data calculated at other pressure bases, if such other pressure bases are identified in the filing.

2. Estimates of Future Net Revenues

Facts: Paragraphs 30–34 of Statement 69 require the disclosure of the standardized measure of discounted future net cash flows from production of proved oil and gas reserves, computed by applying year-end prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements) to estimated future production as of the latest balance sheet date, less estimated future expenditures (based on current costs) of developing and producing the proved

reserves, and assuming continuation of existing economic conditions.

Question 1: For purposes of determining reserves and estimated future net revenues, what price should be used for gas which will be produced after an existing contract expires or after the redetermination date in a contract?

Interpretive Response: The price to be used for gas which will be produced after a contract expires or has a redetermination is the current market price at the end of the fiscal year for that category of gas. This price may be increased thereafter only for additional fixed and determinable escalations, as appropriate, for that category of gas. A fixed and determinable escalation is one which is specified in amount and is not based on future events such as rates of inflation.

Question 2: What price should be applied to gas which at the end of a fiscal year is not yet subject to a gas sales contract?

Interpretive Response: The price to be used is the current market price for similarly situated gas at the end of the fiscal year provided the company can reasonably expect to sell the gas at the prevailing market price.

Question 3: To what extent should price increases announced by OPEC or by certain government agencies not yet effective at the date of the reserve report be considered in determining current prices?

Interpretive Response: Current prices should not reflect price increases announced but not yet effective at the date of the reserve valuation, *i.e.*, the end of the fiscal year.

3. Disclosure of Reserve Information

a. Deleted by SAB 103

b. Unproved properties

Facts: Disclosures of reserve information are based on estimated quantities of proved reserves of oil and gas. Regulation S–K prohibits disclosure of estimated quantities of probable or possible reserves of oil and gas and any estimated value thereof in any document publicly filed with the Commission.

Question: What types of disclosures will be permitted by registrants who wish to indicate that some of their properties have value other than that attributable to proved reserves?

Interpretive Response: The Office of Engineering has, for the past several years, suggested to registrants the following form of disclosure for undeveloped lease acreage:

In addition to proved reserves, the estimated (or appraised) value of leases or parts of leases to which proved reserves cannot be attributable is \$xxx.

this principle in the minutes of EITF Issue 88–19, and an announcement by the SEC Observer to the EITF at the February 23, 1989 meeting.

² See EITF Issue 88–19 for guidance on the appropriate period in which to record certain types of regulatory assistance.

³ See Section 501.06.c. of the Financial Reporting Codification for further discussion of the MD&A disclosures of the effects of regulatory assistance.