Statement of Financial Accounting Standards No. 69

FAS69 Status Page
FAS69 Summary

Disclosures about Oil and Gas Producing Activities

an amendment of FASB Statements 19, 25, 33, and 39

November 1982

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

Statement of Financial Accounting Standards No. 69

Disclosures about Oil and Gas Producing Activities

an amendment of FASB Statements 19, 25, 33 and 39

November 1982

CONTENTS

FAS 69: Disclosures about Oil and Gas Producing Activities

an amendment of FASB Statements 19, 25, 33, and 39

FAS 69 Summary

This Statement establishes a comprehensive set of disclosures for oil and gas producing activities and replaces requirements of several earlier Statements. The requirement to disclose the method of accounting for costs incurred in oil and gas producing activities and the manner of disposing of related capitalized costs is continued for both publicly traded and other enterprises. None of the other requirements in this Statement is extended to enterprises that are not publicly traded, thereby eliminating existing requirements for them to disclose information about proved oil and gas reserve quantities, capitalized costs, and costs incurred.

Publicly traded enterprises with significant oil and gas activities, when presenting a complete set of annual financial statements, are to disclose the following as supplementary information, but not as a part of the financial statements:

a. Proved oil and gas reserve quantities
b. Capitalized costs relating to oil and gas producing activities
c. Costs incurred in oil and gas property acquisition, exploration, and development activities
d. Results of operations for oil and gas producing activities
e. A standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities

This Statement eliminates a previous requirement to disclose capitalized costs in complete sets of interim financial statements.

In addition, this Statement permits historical cost/constant dollar measures to be used for oil and gas mineral interests when presenting current cost information under the provisions of FASB Statement No. 39, *Financial Reporting and Changing Prices: Specialized Assets—Mining and Oil and Gas.*

INTRODUCTION

1. This Statement amends FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies,* by establishing disclosures about oil and gas producing activities [1] to be made for publicly traded enterprises [2] when presenting a complete set of annual financial statements.[3] Those disclosures include the information required by Statement 19 and FASB Statement No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies,* concerning proved oil and gas reserve quantities, capitalized costs, costs incurred, and the method of accounting for costs incurred for an enterprise's oil and gas producing activities. Information about the results of operations for oil and gas producing activities, a standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities, and summary information about oil and gas producing activities associated with equity investments and minority interests also is required to be disclosed. The accounting method shall be disclosed within the financial statements; the other disclosures are considered to be supplementary information.

2. This Statement also amends Statement 19 to eliminate, for enterprises that are not publicly traded, the requirement to disclose information concerning capitalized costs, costs incurred, and proved oil and gas reserve quantities. However, this Statement maintains the requirement of Statement 25 for all enterprises to disclose the method of accounting for costs incurred in oil and gas producing activities and the manner of disposing of capitalized costs relating to those activities.

3. In addition, this Statement permits historical cost/constant dollar measures to be used when presenting current cost information about oil and gas mineral interests under the provisions of FASB Statement No. 39, *Financial Reporting and Changing Prices: Specialized Assets—Mining and Oil and Gas.*

4. Appendix A contains summaries and illustrations of certain disclosures about oil and gas producing activities set forth in this Statement. Background information highlighting the pertinent events that preceded the issuance of this Statement is set forth in Appendix B. The basis for the Board's conclusions, including alternative approaches considered in developing the disclosures for oil and gas producing activities, is discussed in Appendix C.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendments to Statements 19, 25, 33, and 39

5. Paragraphs 48-59 of Statement 19, as amended by Statement 25, are superseded by paragraphs 6-34 of this Statement. Paragraphs 51-53 of FASB Statement No. 33, *Financial Reporting and Changing Prices,* as amended by Statement 39, are amended by paragraphs 35-38 of this Statement. **(Amendments to Statements 19 and 33 contained in this Statement are indicated by shading.)**

Applicability and Scope

6. All enterprises engaged in oil and gas producing activities shall disclose in their financial statements the method of accounting for costs incurred in those activities and the manner of disposing of capitalized costs relating to those activities.

7. In addition, publicly traded enterprises that have significant oil and gas producing activities shall disclose with complete sets of annual financial statements the information required by paragraphs 10-34 of this Statement. Those disclosures relate to the following and are considered to be supplementary information:

a. Proved oil and gas reserve quantities
b. Capitalized costs relating to oil and gas producing activities
c. Costs incurred for property acquisition, exploration, and development activities
d. Results of operations for oil and gas producing activities
e. A standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities

8. For purposes of this Statement, an enterprise is regarded as having significant oil and gas producing activities if it satisfies one or more of the following tests. The tests shall be applied separately for each year for which a complete set of annual financial statements is presented.

a. Revenues from oil and gas producing activities, as defined in paragraph 25 (including both sales to unaffiliated customers and sales or transfers to the enterprise's other operations), are 10 percent or more of the combined revenues (sales to unaffiliated customers and sales or transfers to the enterprise's other operations) of all of the enterprise's industry segments.[4]
b. Results of operations for oil and gas producing activities, excluding the effect of income taxes, are 10 percent or more of the greater of:
   (1) The combined operating profit of all industry segments that did not incur an operating loss

(2) The combined operating loss of all industry segments that did incur an operating loss

c. The identifiable assets, defined in a similar manner as in paragraph 10 of FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise,* relating to oil and gas producing activities are 10 percent or more of the combined identifiable assets of all industry segments.

9. The disclosures set forth in this Statement are not required in interim financial reports. However, interim financial reports shall include information about a major discovery or other favorable or adverse event that causes a significant change from the information presented in the most recent annual financial report concerning oil and gas reserve quantities.

Disclosure of Proved Oil and Gas Reserve Quantities

10. Net quantities of an enterprise's interests in proved reserves and proved developed reserves of (a) crude oil (including condensate and natural gas liquids) [5] and (b) natural gas shall be disclosed as of the beginning and the end of the year. "Net" quantities of reserves include those relating to the enterprise's operating and nonoperating interests in properties as defined in paragraph 11(a) of Statement 19. Quantities of reserves relating to royalty interests owned shall be included in "net" quantities if the necessary information is available to the enterprise; if reserves relating to royalty interests owned are not included because the information is unavailable, that fact and the enterprise's share of oil and gas produced for those royalty interests shall be disclosed for the year. "Net" quantities shall not include reserves relating to interests of others in properties owned by the enterprise.

11. Changes in the net quantities of an enterprise's proved reserves of oil and of gas during the year shall be disclosed. Changes resulting from each of the following shall be shown separately with appropriate explanation of significant changes:

a. *Revisions of previous estimates.* Revisions represent changes in previous estimates of proved reserves, either upward or downward, resulting from new information (except for an increase in proved acreage) normally obtained from development drilling and production history or resulting from a change in economic factors.
b. *Improved recovery.* Changes in reserve estimates resulting from application of improved recovery techniques shall be shown separately, if significant. If not significant, such changes shall be included in revisions of previous estimates.
c. *Purchases of minerals in place.*
d. *Extensions and discoveries.* Additions to proved reserves that result from (1) extension of the proved acreage of previously discovered (old) reservoirs through additional drilling in periods subsequent to discovery and (2) discovery of new fields with proved reserves or of new reservoirs of proved reserves in old fields.
e. *Production.*
f. *Sales of minerals in place.*

12. If an enterprise's proved reserves of oil and of gas are located entirely within its home country, that fact shall be disclosed. If some or all of its reserves are located in foreign countries, the disclosures of net quantities of reserves of oil and of gas and changes in them required by paragraphs 10 and 11 shall be separately disclosed for (a) the enterprise's home country (if significant reserves are located there) and (b) each foreign geographic area in which significant reserves are located. Foreign geographic areas are individual countries or groups of countries as appropriate for meaningful disclosure in the circumstances.

13. Net quantities disclosed in conformity with paragraphs 10-12 shall not include oil or gas subject to purchase under long-term supply, purchase, or similar agreements and contracts, including such agreements with ~~foreign~~ governments or authorities. However, quantities of oil or gas subject to such agreements with ~~foreign~~ governments or authorities as of the end of the year, and the net quantity of oil or gas received under the agreements during the year, shall be separately disclosed if the enterprise participates in the operation of the properties in which the oil or gas is located or otherwise serves as the "producer" of those reserves, as opposed, for example, to being an independent purchaser, broker, dealer, or importer.

14. In determining the reserve quantities to be disclosed in conformity with paragraphs 10-13:

a. If the enterprise issues consolidated financial statements, 100 percent of the net reserve quantities attributable to the parent company and 100 percent of the net reserve quantities attributable to its consolidated subsidiaries (whether or not wholly owned) shall be included. If a significant portion of those reserve quantities at the end of the year is attributable to a consolidated subsidiary(ies) in which there is a significant minority interest, that fact and the approximate portion shall be disclosed.
b. If the enterprise's financial statements include investments that are proportionately consolidated, the enterprise's reserve quantities shall include its proportionate share of the investees' net oil and gas reserves.
c. If the enterprise's financial statements include investments that are accounted for by the equity method, the investees' net oil and gas reserve quantities shall not be included in the disclosures of the enterprise's reserve quantities. However, the enterprise's (investor's) share of the investees' net oil and gas reserves shall be separately disclosed as of the end of the year.

15. In reporting reserve quantities and changes in them, oil reserves and natural gas liquids reserves shall be stated in barrels, and gas reserves in cubic feet.

16. If important economic factors or significant uncertainties affect particular components of an enterprise's proved reserves, explanation shall be provided. Examples include unusually high expected development or lifting costs, the necessity to build a major pipeline or other major facilities before production of the reserves can begin, and contractual obligations to produce and sell a significant portion of reserves at prices that are substantially below those at which the oil or gas could otherwise be sold in the absence of the contractual obligation.

17. If a government restricts the disclosure of estimated reserves for properties under its authority, or of amounts under long-term supply, purchase, or similar agreements or contracts, or if the government requires the disclosure of reserves other than proved, the enterprise shall indicate that the disclosed reserve estimates or amounts do not include figures for the named country or that reserve estimates include reserves other than proved.

Disclosure of Capitalized Costs Relating to Oil and Gas Producing Activities

18. The aggregate capitalized costs relating to an enterprise's oil and gas producing activities (paragraph 11 of Statement 19) and the aggregate related accumulated depreciation, depletion, amortization, and valuation allowances shall be disclosed as of the end of the year. Paragraph 5 of APB Opinion No. 12, *Omnibus Opinion—1967,* requires disclosure of "balances of major classes of depreciable assets, by nature or function." Thus, separate disclosure of capitalized costs for asset categories (a) through (d) in paragraph 11 of Statement 19 or for a combination of those categories often may be appropriate.

19. If significant, capitalized costs of unproved properties shall be separately disclosed. Capitalized costs of support equipment and facilities may be disclosed separately or included, as appropriate, with capitalized costs of proved and unproved properties.

20. If the enterprise's financial statements include investments that are accounted for by the equity method, the enterprise's share of the investees' net capitalized costs relating to oil and gas producing activities as of the end of the year shall be separately disclosed.

Disclosure of Costs Incurred in Oil and Gas Property Acquisition, Exploration, and Development Activities

21. Each of the following types of costs for the year shall be disclosed (whether those costs are capitalized or charged to expense at the time they are incurred under the provisions of paragraphs 15-22 of Statement 19): [6]

a. Property acquisition costs
b. Exploration costs
c. Development costs
~~d. Production (lifting) costs~~

22. If some or all of those costs are incurred in foreign countries, the amounts shall be disclosed separately for each of the geographic areas for which reserve quantities are disclosed (paragraph 12). If significant costs have been incurred to acquire mineral interests that have proved reserves, those costs shall be disclosed separately from the costs of acquiring unproved properties.

23. If the enterprise's financial statements include investments that are accounted for by the

equity method, the enterprise's share of the investees' property acquisition, exploration, and development costs incurred in oil and gas producing activities shall be separately disclosed for the year, in the aggregate and for each geographic area for which reserve quantities are disclosed (paragraph 12).

Disclosure of the Results of Operations for Oil and Gas Producing Activities

24. The results of operations for oil and gas producing activities shall be disclosed for the year. That information shall be disclosed in the aggregate and for each geographic area for which reserve quantities are disclosed (paragraph 12). The following information relating to those activities shall be presented: [7]

a. Revenues
b. Production (lifting)costs
c. Exploration expenses [8]
d. Depreciation, depletion, and amortization, and valuation provisions
e. Income tax expenses
f. Results of operations for oil and gas producing activities (excluding corporate overhead and interest costs)

25. Revenues shall include sales to unaffiliated enterprises and sales or transfers to the enterprise's other operations (for example, refineries or chemical plants). Sales to unaffiliated enterprises and sales or transfers to the enterprise's other operations shall be disclosed separately. Revenues shall include sales to unaffiliated enterprises attributable to net working interests, royalty interests, oil payment interests, and net profits interests of the reporting enterprise. Sales or transfers to the enterprise's other operations shall be based on market prices determined at the point of delivery from the producing unit. Those market prices shall represent prices equivalent to those that could be obtained in an arm's-length transaction. Production or severance taxes shall not be deducted in determining gross revenues, but rather shall be included as part of production costs. Royalty payments and net profits disbursements shall be excluded from gross revenues.

26. Income taxes shall be computed using the statutory tax rate for the period, applied to revenues less production (lifting) costs, exploration expenses, depreciation, depletion, and amortization, and valuation provisions. Calculation of income tax expenses shall reflect permanent differences and tax credits and allowances relating to the oil and gas producing activities that are reflected in the enterprise's consolidated income tax expense for the period.

27. Results of operations for oil and gas producing activities are defined as revenues less production (lifting) costs, exploration expenses, depreciation, depletion, and amortization, valuation provisions, and income tax expenses. General corporate overhead and interest costs [9] shall not be deducted in computing the results of operations for an enterprise's oil and gas producing activities. However, some expenses incurred at an enterprise's central administrative

office may not be general corporate expenses, but rather may be operating expenses of oil and gas producing activities, and therefore should be reported as such. The nature of an expense rather than the location of its incurrence shall determine whether it is an operating expense. Only those expenses identified by their nature as operating expenses shall be allocated as operating expenses in computing the results of operations for oil and gas producing activities.

28. The amounts disclosed in conformity with paragraphs 24-27 shall include an enterprise's interests in proved oil and gas reserves (paragraph 10) and in oil and gas subject to purchase under long-term supply, purchase, or similar agreements and contracts in which the enterprise participates in the operation of the properties on which the oil or gas is located or otherwise serves as the producer of those reserves (paragraph 13).

29. If the enterprise's financial statements include investments that are accounted for by the equity method, the investees' results of operations for oil and gas producing activities shall not be included in the enterprise's results of operations for oil and gas producing activities. However, the enterprise's share of the investees' results of operations for oil and gas producing activities shall be separately disclosed for the year, in the aggregate and by each geographic area for which reserve quantities are disclosed (paragraph 12).

Disclosure of a Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities

30. A standardized measure of discounted future net cash flows relating to an enterprise's interests in (a) proved oil and gas reserves (paragraph 10) and (b) oil and gas subject to purchase under long-term supply, purchase, or similar agreements and contracts in which the enterprise participates in the operation of the properties on which the oil or gas is located or otherwise serves as the producer of those reserves (paragraph 13) shall be disclosed as of the end of the year. The standardized measure of discounted future net cash flows relating to those two types of interests in reserves may be combined for reporting purposes. The following information shall be disclosed in the aggregate and for each geographic area for which reserve quantities are disclosed in accordance with paragraph 12:

a. *Future cash inflows.* These shall be computed by applying year-end prices of oil and gas relating to the enterprise's proved reserves to the year-end quantities of those reserves. Future price changes shall be considered only to the extent provided by contractual arrangements in existence at year-end.
b. *Future development and production costs.* These costs shall be computed by estimating the expenditures to be incurred in developing and producing the proved oil and gas reserves at the end of the year, based on year-end costs and assuming continuation of existing economic conditions. If estimated development expenditures are significant, they shall be presented separately from estimated production costs.
c. *Future income tax expenses.* These expenses shall be computed by applying the appropriate year-end statutory tax rates, with consideration of future tax rates already legislated, to the future pretax net cash flows relating to the enterprise's proved oil and gas reserves, less the

tax basis of the properties involved. The future income tax expenses shall give effect to permanent differences and tax credits and allowances relating to the enterprise's proved oil and gas reserves.

d. *Future net cash flows.* These amounts are the result of subtracting future development and production costs and future income tax expenses from future cash inflows.

e. *Discount.* This amount shall be derived from using a discount rate of 10 percent a year to reflect the timing of the future net cash flows relating to proved oil and gas reserves.

f. *Standardized measure of discounted future net cash flows.* This amount is the future net cash flows less the computed discount.

31. If a significant portion of the economic interest in the consolidated standardized measure of discounted future net cash flows reported is attributable to a consolidated subsidiary(ies) in which there is a significant minority interest, that fact and the approximate portion shall be disclosed.

32. If the financial statements include investments that are accounted for by the equity method, the investees' standardized measure of discounted future net cash flows relating to proved oil and gas reserves shall not be included in the disclosure of the enterprise's standardized measure. However, the enterprise's share of the investees' standardized measure of discounted future net cash flows shall be separately disclosed for the year, in the aggregate and by each geographic area for which quantities are disclosed (paragraph 12).

33. The aggregate change in the standardized measure of discounted future net cash flows shall be disclosed for the year. If individually significant, the following sources of change shall be presented separately:

a. Net change in sales and transfer prices and in production (lifting) costs related to future production
b. Changes in estimated future development costs
c. Sales and transfers of oil and gas produced during the period
d. Net change due to extensions, discoveries, and improved recovery
e. Net change due to purchases and sales of minerals in place
f. Net change due to revisions in quantity estimates
g. Previously estimated development costs incurred during the period
h. Accretion of discount
i. Other—unspecified
j. Net change in income taxes

In computing the amounts under each of the above categories, the effects of changes in prices and costs shall be computed before the effects of changes in quantities. As a result, changes in quantities shall be stated at year-end prices and costs. The change in computed income taxes shall reflect the effect of income taxes incurred during the period as well as the change in future income tax expenses. Therefore, all changes except income taxes shall be reported pretax.

34. Additional information necessary to prevent the disclosure of the standardized measure of discounted future net cash flows and changes therein from being misleading also shall be provided.

Disclosure of Current Cost Information

35. In applying the provisions of Statement 39 for presenting supplementary information on a current cost basis, this Statement permits enterprises to use historical cost/constant dollar measures of oil and gas mineral resource assets and related expense. As a result of this provision, together with the provision of paragraph 31 of Statement 33, an enterprise needs to present supplementary information on a current cost basis only if it has significant holdings of inventory and property, plant, and equipment apart from oil and gas producing activities or certain other specialized assets.

36. Paragraph 53(a) of Statement 33, as amended by Statements 39, 40, 41, and 46,[10] is superseded by the following:

a. When an enterprise presents information on a current cost basis for fiscal years ended on or after December 15, 1982, it shall measure:
   (1) Oil and gas mineral resource assets and related expenses at either their historical cost/constant dollar amounts or current cost or lower recoverable amounts
   (2) Mining mineral resource assets and related expenses at their current cost or lower recoverable amounts

37. Paragraph 51(b) of Statement 33, as amended by Statements 39, 40, 41, and 46, is superseded by the following:

b. Property, plant, and equipment at the current cost or lower recoverable amount (paragraphs 57-64) of the assets' remaining service potential at the measurement date. (This provision is qualified by paragraph 53 with respect to timberlands and growing timber, income-producing real estate, motion picture films, and oil and gas mineral resource assets.)

38. Paragraph 52(b) of Statement 33, as amended by Statements 39, 40, 41, and 46, is superseded by the following:

b. Depreciation, depletion, and amortization expense of property, plant, and equipment shall be measured on the basis of the average current cost or lower recoverable amount (paragraphs 57-64) of the assets' service potential during the period of use. (This provision is qualified by paragraph 53 with respect to timberlands and growing timber, income-producing real estate, motion picture films, and oil and gas mineral resource assets.)

Effective Date and Transition

39. This Statement shall be effective for fiscal years beginning on or after December 15, 1982. Earlier application is encouraged but is not required.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of four members of the Financial Accounting Standards Board. Messrs. March, Morgan and Sprouse dissented.

Messrs. March, Morgan, and Sprouse dissent to this Statement because they are opposed to requiring the disclosure of the computation and analysis of a standardized measure of discounted future net cash flows relating to proved oil and gas reserves (paragraphs 30-34). They believe that a requirement to disclose supplementary historical information about proved reserve quantities (paragraphs 10-17), capitalized and incurred costs (paragraphs 18-23), and results of producing activities (paragraphs 24-29) by significant geographic area is adequate to achieve the objectives of this Statement. Those disclosures are important for understanding oil and gas producing activities due to (a) the significance of oil and gas reserves as an economic resource; (b) the relatively long cycle from resource exploration to production, product sale, and ultimate cash flow; and (c) the risks related to geographic location. They help to fill a void caused by the absence of reliable measurements of the cost of finding and developing oil and gas reserves and the lack of a relationship between those costs and the revenues and cash inflows resulting from their disposition in the normal course of business.

Elsewhere, the Board has stated that relevance and reliability are the two primary qualities that make accounting useful for decision making and has adopted the position that if either of those qualities is completely missing, the information will not be useful (FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*). The dissenting Board members believe the the proposed standardized measure of discounted future net cash flows is completely lacking in reliability. The reliability of a measure rests on the faithfulness with which it represents what it purports to represent (representational faithfulness), coupled with an assurance for the user that is has that representational quality (verifiability). Representational faithfulness is correspondence or agreement between a measure or description of an economic resource and the phenomenon that the measure or description purports to represent. The phenomenon being measured or described must be something that actually exists; the arithmetical results of a prescribed calculation that does not even purport to represent current cost, historical cost, fair market value, or any other real-world phenomenon cannot have representational faithfulness. Indeed, one of the concerns is that many users would not understand that the result of the standardized calculation itself is not intended to measure fair market value, the present value of future net cash flows, value to the business, or any other economic attribute (paragraphs 77 and 83) and might assume erroneously that it is some kind of an estimate of fair value.

Although it would be possible to provide assurance to users that the arithmetic involved in computing the standardized measure has been properly performed, it is impossible to verify the future. The standardized calculation depends largely upon management's forecasts of future production quantities, not only for the immediate future but for the entire period required to exhaust the existing estimated quantity of proved reserves. It is true that the discounting process automatically gives less weight to those forecasts the further into the future they extend, but the proposed disclosures do not provide adequate information for users, other than perhaps the most sophisticated, to assess the underlying production forecast itself.

Although the Board has not taken a position on reporting management forecasts generally, in Concepts Statement No. 1, *Objectives of Financial Reporting of Business Enterprises,* it characterizes financial statements and financial reporting as largely reflecting the financial effects of transactions and events that have already happened. Those who use the information provided by financial reporting may try to predict the future, but that is the essence of investment decision making, not the objective of financial reporting. The dissenting Board members are unconvinced that the case for a standardized measure of discounted future net cash flows that depends on management production forecasts is greater for enterprises engaged in oil and gas producing activities than for enterprises engaged in any other activity.

The dissenting Board members also are not convinced of the purported usefulness of the standardized measure as a benchmark to permit comparison of enterprises on a relative scale. The subjectivity of the estimates of quantities and production rates is too great. Each management's different expectations about what the future holds (for example, the future demand for energy, future use of alternative sources of energy, and future political stability among oil and gas producing nations) will be reflected in its critical production forecasts. Only if a user reflects his or her own set of expectations in predicting the future activities and results of various enterprises is comparability possible.

Disclosures of historical information about revenues, costs, and production permit users to determine average unit prices received and average unit costs incurred in each significant geographic area and to make their own predictions about future production, prices, costs, net cash flows, and risks. Predicting the future is the users' responsibility; it is not an appropriate objective of financial reporting. The cost of calculation a standardized measure in which comprehensive management production forecasts are inextricably intermingled with current costs and prices and weighted with a prescribed 10-percent discount rate is likely to exceed the limited benefits of that disclosure.

Members of the Financial Accounting Standards Board:

Appendix A: SUMMARIES AND ILLUSTRATIONS OF CERTAIN DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES

40. Following are summaries and illustrations of certain of the disclosure requirements for oil and gas producing activities required by this Statement.

	Disclosure Illustration
Accounting Method	
Method of accounting for costs incurred and the manner of disposing of capitalized costs relating to oil and gas producing activities	—
Capitalized Costs	
Aggregate amount of capitalized costs and related accumulated depreciation, depletion, and amortization, and valuation allowances (If significant, capitalized costs of unproved properties shall be separately disclosed.)	1
Enterprise's share of equity method investees' capitalized costs in the aggregate at the end of the year	1
Costs Incurred in Oil and Gas Property Acquisition, Exploration, and Development	
Costs incurred in oil and gas producing activities in the aggregate, by type, and by geographic area during the year (If significant, costs of acquiring existing mineral interests that have proved reserves shall be disclosed separately from the costs of acquiring unproved properties.)	2

Enterprise's share of equity method investees' costs incurred in the aggregate and by geographic area during the year	2
Results of Operations	
Results of operations for the year from oil and gas producing activities and the major components of those activities in the aggregate and by geographic area	3
Enterprise's share of equity method investees' results of operations for the year from oil and gas producing activities in the aggregate and by geographic area	3
Reserve Quantity Information	
Net quantities of proved reserves and proved developed reserves at the beginning and end of the year and changes in proved reserves in the aggregate, by type, and by geographic area	4
Reserves subject to purchase under supply agreements with governments or authorities in which the enterprise acts as producer, and reserves received under those agreements during the year in the aggregate and by geographic area	4
Enterprise's share of equity method investees' proved reserves at the end of the year in the aggregate and by geographic area	4
Approximate portion of reserves quantities at the end of the year attributable to a consolidated subsidiary(ies) in which there is a significant minority interest	4
Important economic factors and significant uncertainties affecting an enterprise's proved reserves	—
Governmental restrictions on reporting reserve information	—

Standardized Measure of Discounted Future Net Cash Flows

Standardized measure of discounted future net cash flows and major components of that calculation relating to proved reserve quantities (including those relating to long-term supply agreements for which the enterprise acts as producer) at the end of the year in the aggregate and by geographic area, based on year-end prices, costs, and statutory tax rates (adjusted for permanent differences) and a 10-percent annual discount rate	5
Enterprise's share of equity method investees' standardized measure of discounted future net cash flows in the aggregate and by geographic area	5
Approximate portion of economic interests in the consolidated standardized measure of discounted future net cash flows at the end of the year attributable to a consolidated subsidiary(ies) in which there is a significant minority interest	5
Summary of changes in the standardized measure of discounted future net cash flows during the year in the aggregate	5
Additional information concerning the standardized measure of discounted future net cash flows required to prevent the information from being misleading	—

41. The following illustrations present formats that may be used to disclose certain information required by this Statement when a complete set of annual financial statements is presented for one year.

Illustration 1

CAPITALIZED COSTS RELATING TO
OIL AND GAS PRODUCING ACTIVITIES
AT DECEMBER 31, 19XX

	Total
Unproved oil and gas properties	$X
Proved oil and gas	X
	X
Accumulated depreciation, depletion, and amortization, and valuation allowances	X
Net capitalized costs	$X
Enterprise's share of equity method investees' net capitalized costs	$X

Illustration 2

COSTS INCURRED IN OIL AND GAS PROPERTY ACQUISITION,
EXPLORATION, AND DEVELOPMENT ACTIVITIES
FOR THE YEAR ENDED 31, 19XX

	Total	United States	Foreign Geographic Area A	Foreign Geographic Area B	Other Foreign Geographic Areas
Acquisition of properties					
— Proved	$X	$X	$X	$X	$X
— Unproved	X	X	X	X	X
Exploration costs	X	X	X	X	X
Development costs	X	X	X	X	X
Enterprise's share of equity method investees' costs of property acquisition, exploration, and development	X	X	X	X	X

Illustration 3

RESULTS OF OPERATIONS FOR PRODUCING ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 19XX

	Total	United States	Foreign Geographic Area A	Foreign Geographic Area B	Other Foreign Geographic Areas
Revenues					
Sales	$ X	$ X	$ X	$ X	$ X
Transfers	X	X	X	X	X
Total	X	X	X	X	X
Production costs	(X)	(X)	(X)	(X)	(X)
Exploration expenses	(X)	(X)	(X)	(X)	(X)
Depreciation, depletion, and amortization, and valuation provisions	(X)	(X)	(X)	(X)	(X)
	X	X	X	X	X
Income tax expenses	(X)	(X)	(X)	(X)	(X)
Results of operations from producing activities (excluding corporate overhead and interest costs)	$ X	$ X	$ X	$ X	$ X
Enterprise's share of equity method investees' results of operations for producing activities	$ X	$ X	$ X	$ X	$ X

Illustration 4

RESERVE QUANTITY INFORMATION*
FOR THE YEAR ENDED DECEMBER 31, 19XX

	Total		United States		Foreign Geographic Area A		Foreign Geographic Area B		Other Foreign Geographic Areas	
	Oil	Gas	Oil	Gas	Oil	Gas	Oil	Gas	Oil	Gas
Proved developed and undeveloped reserves:										
Beginning of year	X	X	X	X	X	X	X	X	X	X
Revisions of previous estimates	X	X	X	X	X	X	X	X	X	X
Improved recovery	X	X	X	X	X	X	X	X	X	X
Purchases of minerals in place	X	X	X	X	X	X	X	X	X	X
Extensions and discoveries	X	X	X	X	X	X	X	X	X	X
Production	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Sales of minerals in place	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
End of year	X†	X	X	X	X	X	X	X	X	X
Proved developed reserves:										
Beginning of year	X	X	X	X	X	X	X	X	X	X

End of year	X	X	X	X	X	X	X	X	X	X
Oil and gas applicable to long-term supply agreements with governments or authorities in which the enterprise acts as producer:										
Proved reserves—end of year	X	X			X	X				
Received during the year	X	X			X	X				
Enterprise's proportional interest in reserves of investees accounted for by the equity method—end of year	X	X	X	X	X	X	X	X	X	X

* Oil reserves stated in barrels; gas reserves stated in cubic feet.

† Includes reserves of X barrels attributable to a consolidated subsidiary in which there is an X-percent minority interest.

Illustration 5

STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS AND CHANGES THEREIN RELATING TO PROVED OIL AND GAS RESERVES AT DECEMBER 31, 19XX

	Total	United States	Foreign Geographic Area A	Foreign Geographic Area B	Other Foreign Geographic Areas
Future cash inflows *	$ X	$ X	$ X	$ X	$ X
Future production and development costs *	(X)	(X)	(X)	(X)	(X)
Future income tax expenses *	(X)	(X)	(X)	(X)	(X)
Future net cash flows 10% annual	X	X	X	X	X
discount for estimated timing of cash flows	(X)	(X)	(X)	(X)	(X)
Standardized measure of discounted future net cash flows	$ X†	$ X	$ X	$ X	$ X
Enterprise's share equity method investees' standardized measure of discounted future net cash flows	$ X	$ X	$ X	$ X	$ X

The following are the principal sources of change in the standardized measure of discounted future net cash flows during 19XX:

Sales and transfers of oil and gas produced, net of production costs	$(X)

Net changes in prices and production costs	X
Extensions, discoveries, and improved recovery, less related costs	X
Development costs incurred during the period	(X)
Revisions of previous quantity estimates	X
Accretion of discount	X
Net change in income taxes	X
Other	X

---

* Future net cash flows were computed using year-end prices and costs, and year-end statutory tax rates (adjusted for permanent differences) that relate to existing proved oil and gas reserves in which the enterprise has mineral interests, including those mineral interests related to long-term supply agreements with governments for which the enterprise serves as the producer of the reserves.

† Includes $X attributable to a consolidated subsidiary in which there is an X-percent minority interest.

Appendix B: BACKGROUND INFORMATION

42. In December 1977, Statement 19 was issued by the Board. That Statement adopted a form of successful efforts accounting and required disclosure of proved oil and gas reserve quantities, capitalized costs, and costs incurred in oil and gas producing activities.

43. Before Statement 19 became effective, the Securities and Exchange Commission (SEC) issued, in August 1978, ASR No. 253, *Adoption of Requirements for Financial Accounting and Reporting Practices for Oil and Gas Producing Activities.*[11] That release (a) adopted the form of successful efforts accounting prescribed by Statement 19, (b) indicated an intention to adopt the disclosures prescribed by Statement 19 (which was subsequently done), (c) indicated an intention to adopt a form of the full cost accounting method (which was subsequently done), (d) permitted the use of either (a) or (c) for SEC reporting purposes, and (e) adopted rules requiring disclosure of certain financial and operating information beyond that required in Statement 19. The SEC took those actions because it believed that neither the full cost nor the successful efforts method provided sufficient information on the financial position and operating results of oil and gas producing enterprises. Accordingly, the SEC concluded that a new method of accounting that is based on valuations of proved oil and gas reserves and that would replace both the successful efforts and full cost accounting methods should be developed for the primary financial statements. The SEC initiated the development of that new accounting method (which it referred to as reserve recognition accounting [RRA]) by requiring supplemental disclosures on that basis. The SEC also indicated (and subsequently carried out) its intention to require the disclosure of a supplemental earnings summary to reflect estimated additions to proved reserves and changes in valuation of estimated proved reserves, based on current prices and a 10-percent discount rate. All costs associated with finding and developing such additions and all costs determined to be nonproductive during the period are deducted in determining that supplemental measure of earnings.

44. In February 1979—because Statement 19 requirements would be imposed only on enterprises not subject to SEC reporting requirements and therefore would not achieve comparability—the Board issued Statement 25, which suspended the effective date of Statement 19 as to the accounting method to be used in financial statements but not as to the disclosure requirements.

45. Further supplemental information is presently required to be disclosed by Statements 33 and 39. Those Statements require large publicly held oil and gas enterprises to report the effects of changes in general prices and changes in specific prices of certain types of assets.

46. During the development of Statement 39, the Board recognized that the accumulation of both the Board's and the SEC's disclosure requirements placed a significant burden on oil and

gas producing enterprises. It recognized that the disclosures made in response to those requirements may have become unnecessarily voluminous and complex without a corresponding increase in their usefulness to the users of financial statements. Furthermore, other information, frequently suggested by some financial analysts as useful, was not presented. Accordingly, the Board indicated that it would study the usefulness of the existing and proposed disclosures and would work with the oil and gas industry, the SEC, and users to develop a single, coherent set of disclosure requirements for oil and gas producing enterprises.

47. On February 26, 1981, the SEC issued ASR No. 289, *Financial Reporting by Oil and Gas Producers,* which states that the SEC no longer considers RRA to be a potential method of accounting in the primary financial statements of oil and gas producers. That release also announced the Commission's "support of an undertaking by the Financial Accounting Standards Board to develop a comprehensive package of disclosures for those engaged in oil and gas producing activities." The Commission indicated in that release that it expected to amend its rules to be consistent with the disclosure standards for oil and gas producers to be developed by the FASB for oil and gas producers.

48. The Board added a project on disclosures about oil and gas producing activities to its agenda on March 4, 1981.

49. A task force comprising 20 people from the oil and gas industry, petroleum engineering and geological consulting firms, the financial community, the public accounting profession, and academe was formed at the outset of the project to advise the staff on technical matters encompassed in the scope of the project.

50. On May 13, 1981, the Board published the FASB Invitation to Comment, *Disclosures about Oil and Gas Producing Activities.* The Board received 120 letters in response to that Invitation to Comment.

51. In August 1981, the Board conducted a public hearing on the Invitation to Comment. Twenty-eight organizations and individuals presented their views at the two-day hearing.

52. On April 15, 1982, the Board issued an FASB Exposure Draft, *Disclosures about Oil and Gas Producing Activities.* The Board received 113 letters of comment on that Exposure Draft.

53. Since the project was added to the Board's agenda, the Board held 10 open meetings at which the project's issues were discussed. The Task Force on Disclosures about Oil and Gas Producing Activities met three times with the FASB staff, and individuals serving on the task force participated in open educational Board meetings held on the project's issues. Task force members provided the Board and its staff with comments on those issues.

Appendix C

BASIS FOR CONCLUSIONS

CONTENTS

Paragraph Numbers

Appendix C: BASIS FOR CONCLUSIONS

Introduction

54. This appendix reviews considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

55. The underlying causes of the problem leading to this Statement relate to some significant and unusual economic characteristics of oil and gas producing activities:

a. The principal assets are oil and gas reserves.
b. There is no necessary correlation between the costs and the values of oil and gas reserves.
c. The costs of finding specific reserves are unique.

The costs of existing reserves, therefore, are not relevant indicators of either (a) cash inflows from production and sale of those reserves or (b) cash outflows necessary to replace those reserves.

56. An important quality of information that is useful in making rational investment, credit, and similar decisions is its predictive value—specifically, its usefulness in assessing the amounts, timing, and uncertainty of prospective net cash inflows to the enterprise. Historical cost based financial statements for oil and gas producing enterprises have limited predictive value. Their usefulness is further reduced because a uniform accounting method is not required to be used for costs incurred in oil and gas producing activities.

57. The inherent limitations involved in using historical cost based information relative to mineral interests in properties have long been recognized. Various attempts have been made to standardize the industry's method of accounting for costs incurred in oil and gas producing activities. Those attempts have not been successful.

58. Other attempts have been made by the FASB and the SEC (current cost accounting and RRA) to develop disclosures to assist the user to:

a. Assess future net cash flows
b. Estimate the values or replacement costs of mineral reserves
c. Compare financial positions and operating results of enterprises in the industry

59. Those attempts have resulted in a great volume of additional disclosures, particularly for publicly owned oil and gas producing enterprises. The Board's project is an attempt, by agreement with the SEC, to analyze the problem, to sort out the reasonable needs of users, and to determine what information will help to meet those needs at a reasonable cost.

60. In summary, the primary objectives of this Statement are:

a. To develop disclosure requirements that are useful and in particular would compensate, in some measure, for recognized deficiencies in the comparability and predictive value of financial statement information of oil and gas enterprises
b. To consider cost-benefit relationships of alternative disclosures and to reduce the quantity and cost of existing disclosures

Alternatives Considered

61. The Board considered four basic approaches to developing comprehensive oil and gas disclosures:

A - Historical cost based information and reserve quantity information *only*
B - Historical cost based information and reserve quantity information *plus* future estimated costs and reserve production information
C - Historical cost based information and reserve quantity information *plus* information about estimated future net cash flows relating to oil and gas reserves
D - Historical cost based information and reserve quantity information plus information about estimated future net cash flows relating to oil and gas reserves *and* an alternative measure of income based on changes in those future net cash flows

62. Most respondents to the Invitation to Comment and the Exposure Draft support the Board's conclusion in Statement 19 that for users to understand and interpret an enterprise's financial statements, information about its oil and gas producing activities must be supplemented by information about its mineral interests. The discovery of proved oil and gas reserves is a critical event in the oil and gas producing cycle, and information about those reserves and changes in them are key indicators of the success of an enterprise. That information is considered so useful in decision making that the lack of precision associated with the estimate of proved oil and gas reserve quantities is more than compensated for by the added relevance to users.

63. All four alternatives considered by the Board provide historical cost based and reserve quantity information. However, they differ on the extent to which that information is considered sufficient to meet the objectives of financial reporting for oil and gas producing activities.

Historical Cost Based Information and Reserve Quantity Information

64. Some respondents to the Invitation to Comment and the Exposure Draft support disclosure

of only historical cost based information and proved oil and gas reserve quantity information (Alternative A). They believe that users can apply current costs and prices or their own estimates of future costs and prices to an extrapolation of historical production trends to estimate future net cash flows related to the enterprise's proved oil and gas reserves. Supporters of this alternative generally believe that disclosure of fair market value, discounted future net cash flows, or projections of future events or conditions relating to an enterprise's proved oil and gas reserves should not be part of financial reporting.

65. In the Board's view, historical cost based financial information and proved oil and gas reserve quantity information are crude tools for any predictive analytical process for many reasons, the most notable of which are:

a. Mineral interests in proved oil and gas reserves may have significantly different economic values because of such features as location, qualitative properties, development status, and tax status. Reserve quantity information does not give a comparable base for comparison over time or among companies.
b. Historical production trends, even if determinable, may differ significantly from management's future production plans.

66. Alternative A, then, is subject (as are all alternatives considered) to the challenge of the reliability of the proved oil and gas reserve estimates and, in addition, does not add materially to users' ability to make comparisons and to assess the future net cash flows of oil and gas producing enterprises.

Estimated Future Costs and Reserve Production Information

67. A few respondents to the Invitation to Comment and the Exposure Draft support, in addition to historical cost based information and proved oil and gas reserve quantity information, disclosure of additional information about oil and gas producing activities that would provide forecasts of (a) estimated future costs of production (lifting) and development of existing proved oil and gas reserves and (b) estimated timing of future production of those reserves (Alternative B). Supporters of this alternative generally suggest limiting the disclosure requirements for that information to a period encompassing the following three to five years. This alternative is intended to allow users of the financial reports of oil and gas producing enterprises to compute estimated near-term future cash flows using their own assumptions concerning future prices and risks.

68. The lack of broad support for Alternative B seems to reflect primarily three views:

a. An objection to presenting explicit forecasts of production and costs in financial reports
b. A concern that, for data to be useful, they would have to be presented separately for each significant field
c. A belief that the data would tend to be used by only the most sophisticated industry analysts

69. The Board was dissuaded from this alternative primarily by the combination of the large volume of data to be presented and the limited number of probable users.

Information about Future Net Cash Flows

70. Some respondents to the Invitation to Comment and to the Exposure Draft supported disclosure of summary information regarding the future net cash flows associated with an enterprise's existing proved oil and gas reserves (Alternative C). This Statement reflects an Alternative C approach to developing disclosure requirements for oil and gas producing activities.

71. The Board considered various means of providing relevant summary information:

a. Fair market value
b. Estimate of discounted net cash flows based on future prices and costs and an enterprise-specific discount rate
c. Standardized measure of discounted future net cash flows with major factors separately reported

Fair Market Value

72. *Fair market value* is usually defined as the exchange price that reasonably could be expected in an arm's-length transaction between a willing buyer and a willing seller. If ascertainable, fair market value would be better than historical cost for indicating future net cash flows relating to oil and gas properties. It also would have been better than the standardized discounted future net cash flows approach required by this Statement because, among other factors, the fair market value of mineral interests in properties includes the "value" of all the various categories of reserves (proved, possible, and probable) as well as undeveloped acreage.

73. Nevertheless, the Board concluded that a requirement to disclose fair market value would be impracticable because:

a. Relatively few exchanges of oil and gas mineral interests take place.
b. Mineral interests that are exchanged tend to be interests in smaller properties that principally involve undeveloped acreage.
c. The geological characteristics of each oil and gas property are unique to that individual mineral interest.
d. The amount of information concerning sales price and stratigraphic data available to parties not directly involved in the exchange is limited because that information usually is considered confidential.

Discounted Future Net Cash Flows

74. The Board considered the use of discounted future net cash flows based on estimated

future prices and costs, production timing, and an enterprise-specific discount rate as a surrogate for fair market value. The Board rejected that approach, however, for a number of reasons.

75. As a practical matter, the estimate would have to be limited to proved reserves because information about probable and possible reserves and undeveloped acreage can be little more than conjectural. Limiting the estimate to proved reserves, however, would seriously detract from the estimate as a representation of fair market value.

76. Estimates of future costs and prices are highly subjective, depending on political events (for example, price controls, tax policy, embargoes, and political upheavals) in addition to supply and demand factors. Estimates of future production are also subject to a wide range of error, and selection of a discount rate is subjectively variable due to individual assessments of political, operating, and general business risks. This combination of subjective estimating variables could not result in information with the necessary degree of verifiability and comparability required for financial reporting.

Standardized Measure of Discounted Net Cash Flows

77. The Board finally settled on a standardized measure of discounted net cash flows to achieve some of the characteristics of a fair market value measure without the extreme subjectivity inherent in either direct estimation of market value or entity-specific discounted net cash flows. Although it cannot be considered an estimate of fair market value, the standardized measure of discounted net cash flows should be responsive to some of the key variables that affect fair market value, namely, changes in reserve quantities, selling prices, production costs, and tax rates.

78. Some respondents to the Invitation to Comment and the Exposure Draft, including financial analysts who specialize in oil and gas securities and petroleum engineers, believe that the disclosure of a standardized measure of discounted future net cash flows associated with an enterprise's proved oil and gas reserves is useful.[12] In ASR 253, the SEC required a measure based on year-end prices and costs specific to the enterprise's proved oil and gas reserves, a standard discount rate of 10 percent, and an estimate of the production timing of those reserves. The Board has adopted that approach to requiring information about future net cash flows.

79. One criticism of a standardized measure of discounted net cash flows has been that it is limited to proved reserves, omitting probable and possible reserves. The Board believes, however, that limiting the estimate to proved reserves is appropriate because:

a. Only proved reserves have been defined in a manner that has gained general acceptance by the petroleum engineering profession.
b. Information on proved reserves is already used within the industry to describe and compare oil and gas mineral interests.

Further, proved reserves ordinarily will be produced sooner than other categories of reserves and are weighted more heavily than other types of reserves in calculating discounted net cash flows. Additionally, more risk is associated with other types of reserves, and consequently the cash flows relating to those reserves probably would be discounted at a higher rate than proved reserves. Those two factors would tend to mitigate the effects of limiting the estimated discounted future net cash flows disclosed to proved reserves.

80. Disclosure of the principal components of the standardized measure of discounted future net cash flows provides users with information concerning the factors involved in making the calculation. Users then have standardized data they can adjust as necessary for their own individual estimates of future changes and risks in order to prepare their own assessments of future cash flows. In addition, disclosing both undiscounted and discounted net cash flows provides a means of comparing proved oil and gas reserves both with and without the subjectivity introduced by management's estimate of production timing, although management generally is in a better position than a user to forecast both the production timing and the recovery method of the enterprise's proved oil and gas reserves.

81. Government participation in oil and gas producing activities takes various forms, ranging from participation in production (royalties, either in cash or in kind) to income taxes. As governments devise different methods of participating, problems of classification arise. For example, excise taxes are based on production or revenue and are generally classified as a part of production costs. Other taxes are based on revenues less certain costs and are generally classified as income taxes. Because of those differences in classification, a standardized measure of discounted future net cash flows relating to proved reserves must reflect income taxes to reflect all forms of taxation (those considered as costs of production and those considered as income taxes). The Board also noted that several enterprises already disclose in their annual reports the effects of income taxes on a standardized measure of estimated net cash flows relating to proved reserves.

82. The Board decided not to require disclosure of the periods in which the calculated net cash flows are expected to be realized. That type of detailed information would add some predictive value to the disclosure, but the Board did not consider the added benefits to be sufficient to justify the additional volume of information that would be included in financial reports if that requirement were adopted. Based on respondents' comments to the Exposure Draft, the Board also decided not to require disclosure by geographic area of changes in the standardized measure that occurred during the period. The Board believes that the small reduction in the feedback value of the disclosure caused by the elimination of geographic area information for the types of changes is acceptable considering the resulting large reduction in volume of information from that initially proposed in the Exposure Draft.

83. The Board was persuaded by respondents' comments that the standardized information can be useful and is, in fact, being used. The Board is concerned, at the same time, that users of financial statements understand that it is neither fair market value nor the present value of future

cash flows. It is a rough surrogate for such measures, a tool to allow for a reasonable comparison of mineral reserves and changes through the use of a standardized method that recognizes qualitative, quantitative, geographic, and temporal characteristics. Absent such a tool, there is no reasonable basis for comparing these most important assets and activities; values are not determinable and quantities are not comparable. In addition, the standardized measure provides users with a common base upon which they can prepare their own estimates of future cash flows.

84. Largely because of the limitations of the standardized measure, the Board rejected the presentation of an alternative measure of income based on changes in the standardized cash flows (Alternative D).

Historical Cost Based Information and Reserve Quantity Information

85. This Statement sets forth disclosure requirements for historical cost based information and reserve quantity information about oil and gas producing activities of the type presently required by the FASB and the SEC. Some of those existing disclosure requirements have been continued in this Statement, while other requirements have either been reorganized or omitted from the Board's disclosure requirements. The Board's considerations of the principal disclosures of historical cost based information and reserve quantity information are discussed below.

Accounting Method

86. Because of past SEC action and the related FASB suspension of the effective date for the accounting requirements of Statement 19, all oil and gas producing enterprises do not use a single method of accounting for costs incurred in oil and gas producing activities. Therefore, the Board has continued the requirement in Statement 25 to disclose in the financial statements the method of accounting and the manner of disposition of capitalized costs.

Capitalized Costs

87. Separately disclosing capitalized costs related to proved and unproved properties will assist users in assessing the degree of risk associated with those two different types of assets. Unproved properties have a much higher degree of risk associated with them since many of them may never result in additions to an enterprise's proved oil and gas reserves. Disclosure of the costs associated with unproved properties also helps users of an oil and gas enterprise's financial statements to assess the enterprise's efforts to maintain an inventory of properties in which it seeks to find additional oil and gas reserves and thereby to maintain or increase its existing oil and gas production level. The Board and most respondents therefore believe that it is appropriate to continue the requirement in Statement 19 to disclose the aggregate amount of capitalized costs and to expand it to require separate disclosure of capitalized costs related to unproved properties.

88. Some respondents suggested that capitalized costs information be required to be disclosed

by geographic area to allow an evaluation of an enterprise's risks by geographic area. The Board disagrees with that suggestion because information concerning the enterprise's risks by geographic area is provided to the users of the enterprise's financial reports by the reserve quantity and standardized measure information required to be disclosed.

Costs Incurred

89. The Board and most respondents believe that it is necessary to continue the requirement in Statement 19 to disclose information about costs incurred during the period because that information indicates management's efforts to replace its existing proved reserves. Disclosure of costs by type also allows users of the financial statements to assess the emphasis of the enterprise's oil and gas producing activities because the disclosure provides information about the enterprise's efforts to find new reserves, to develop existing proved reserves, or both. The accomplishments of those efforts over time are indicated by the reserve quantity disclosures and the analysis of changes in a standardized measure of discounted future net cash flows.

90. Several respondents to the Exposure Draft suggested that costs incurred to acquire proved reserves should be disclosed separately, if significant. They believe it is useful to report the costs of acquiring mineral interests in proved reserves separately from the costs of acquiring unproved mineral leases because of the implications and risks associated with each of those types of expenditures. The Board agreed and believes the data is readily obtainable.

91. Several respondents noted that the Exposure Draft proposed that production costs information should be disclosed in both the costs incurred and results of operations information. Those respondents believe that there is no need for this duplicative disclosure of production costs and suggested that the disclosure of production costs be eliminated from the schedule of costs incurred. The Board agreed and eliminated the requirement of Statement 19 to report production costs as part of costs incurred information.

Results of Operations

92. Disclosing the results of operations for oil and gas producing activities by geographic area is useful in evaluating historical results of operations, cash flows, and risks associated with an important portion of a vertically integrated oil and gas enterprise's activities. It is also useful in comparing the historical performance of independent exploration and production enterprises with the producing activities of integrated enterprises and in comparing the performance of one integrated enterprise with that of another.

93. The November 1981 FASB Exposure Draft, *Reporting Income, Cash Flows, and Financial Position of Business Enterprises,* stresses the relevance of separately disclosing information about different activities within complex enterprises. Analysis aimed at predicting the amount, timing, and uncertainty of future cash flows is facilitated by segregating financial information into homogeneous groups. Oil and gas producing activities of an integrated oil and gas enterprise are subject to significantly different degrees of risk than are its other activities (for

example, refining and marketing). Therefore, separately reporting the results of oil and gas producing activities is likely to enhance the predictive value of the information presented by vertically integrated oil and gas producing enterprises.

94. Disclosing the results of operations for oil and gas producing activities also complements the disclosure of the standardized measure of discounted future net cash flows and changes therein. The results of operations provide historical information that may help users to confirm or correct prior expectations about the factors involved in assessing the near-term cash flow potential of the proved reserves from the trends of the historical results of operations.

95. The reasons for requiring the results of operations for oil and gas producing activities to be reported on an after-tax basis are the same as those provided for the standardized measure of discounted future net cash flows (paragraph 81). That is, there are significant differences in the total governmental participation in oil and gas producing activities and differences in the methods by which that participation is achieved (for example, different mixes of royalties, excise taxes, income taxes, and so forth). The Board believes that to provide comparable information all forms of taxation must be reflected in the disclosure.

96. This Statement requires that general corporate expenses and interest expenses not be added to or deducted from the results of operations for an enterprise's oil and gas producing activities because the allocation of those expenses would be subjective and would tend to decrease the comparability of the disclosure.

97. Some Board members and respondents expressed concern about the reliability of using a transfer price between oil and gas producing activities and other internal operations (for example, refining) for vertically integrated enterprises. However, a reliable transfer price appears to be obtainable since local regulatory and taxation authorities ordinarily require separate information about an enterprise's oil and gas producing activities. The price used to prepare that information reflects the effective price after separation of the oil and gas found in the reserves. The requirement to use established prices will increase the comparability of the information in making comparisons of the revenues and results of operations of enterprises' oil and gas producing activities.

98. Another possible transfer-pricing method considered by the Board is the wellhead price, which is the market price established at the well location where the reserves are produced (lifted). The wellhead price ordinarily is comparable to the point-of-delivery price from the producing unit, except for reserves in remote locations for which the initial processing to separate gas from oil is delayed. The Board considers the wellhead price to be less satisfactory because wellhead prices generally do not exist for reserves in remote locations.

99. The Board agreed, however, with those respondents to the Exposure Draft who suggested separate disclosure of revenues from sales and transfers to other operations of the enterprise, and revenues from sales to unaffiliated customers. That disclosure would indicate the

interrelationship between the oil and gas producing activities and the enterprise's other activities. The disclosure of that information makes the disclosure of revenues from oil and gas producing activities consistent with the Statement 14 requirements for business segments.

Reserve Quantity Information

100. As previously indicated, most respondents to the Invitation to Comment and to the Exposure Draft agreed with the Board's conclusions in Statement 19 that information about quantities of oil and gas reserves is useful to understanding and interpreting the financial statements of an oil and gas producing enterprise. The discovery of reserves is a critical event in the oil and gas producing cycle, and reserves and changes in them are key indicators of the success of an enterprise.

101. Respondents also agreed with the Board's conclusions in Statement 19 that reserve quantities and changes in them should be reported separately for each geographic area in which significant reserves are located since such reporting assists in assessing the risks associated with those reserves.

102. Some governments have nationalized or otherwise taken over, in whole or in part, certain properties in which oil and gas producing enterprises previously had mineral interests. Some of those interests have been converted into long-term supply, purchase, or similar agreements with a government or a governmental authority. In some countries, oil and gas producing enterprises can obtain access to oil and gas reserves only through such agreements and not through direct acquisition of mineral interests. If an oil and gas producing enterprise participates in the operation of a property subject to such an agreement or otherwise serves as "producer" of the reserves from the property, disclosure of the reserve quantities identified with, and quantities of oil or gas received under, that type of agreement with those governments or authorities provides useful information. The fact that the reserves are available to an enterprise requires their inclusion to give a complete presentation of the enterprise's reserve position. However, because of the different nature of those agreements (that is, they do not represent direct ownership interests in reserves), those reserve quantities are to be reported separately from the enterprise's own proved reserves.

103. The requirement of Statement 19 to disclose important economic factors and significant uncertainties affecting an enterprise's proved reserves is continued because it provides information that assists users in assessing the economic resources of an oil and gas producing enterprise. Examples of this type of disclosure include expectation of unusually high development or lifting costs, the necessity to build a major pipeline or other major facility before production of the reserves can begin, or contractual obligations to produce and sell a significant portion of reserves at prices that are substantially below those at which the oil and gas could otherwise be sold.

104. Certain governments restrict the disclosure of reserves located within their jurisdiction. Disclosure of restrictions informs users about the completeness and uniformity of the reserve

information presented. Therefore, the Board decided to require disclosure of the existence of any governmental restrictions that affect the completeness of reporting the reserve information.

Equity Method Investees and Minority Interests

105. An enterprise may carry out significant operations through investees to share the high risks of exploration and the high costs of development in some areas. Respondents' comments indicate that such sharing of risks and costs is increasing and that they generally favor disclosing supplemental information about equity investees' oil and gas producing activities. It is most commonly achieved by joint participation agreements without formation of a separate entity. However, if a separate entity is formed and accounted for by the equity method, information needs to be provided about the enterprise's share of the equity investees' capitalized costs, costs incurred, results of operation, proved oil and gas reserve quantities, and standardized measure of discounted future net cash flows. That information should be disclosed for the same reasons that the Board requires disclosure of similar information about an enterprise's consolidated operations—so users can obtain a meaningful understanding of all the oil and gas operations of the enterprise.

106. Several respondents to the Exposure Draft also noted that an enterprise's consolidated financial statements may include subsidiaries with significant minority interests related to oil and gas producing activities. The Board believes that unless significant minority interests in reported oil and gas producing activities are disclosed, users may overestimate the portion of future cash flows that may accrue to an enterprise's shareholders. As indicated earlier, it is important to include disclosures about equity method investees; it is equally important to include disclosures about significant minority interests in consolidated subsidiaries.

107. The Board acknowledges that disclosures about equity investees and minority interests may have implications for other industries that operate through equity investees and that have significant minority interests. Therefore, the Board may reassess the requirements to report information about equity investments and minority interests contained in this Statement upon completion of a project on consolidated financial statements, the equity method, and other procedures for accounting for investments in or other relations with affiliated entities.

Reasons for Omitting Other Disclosures

108. Other disclosures of historical cost based information suggested by respondents or required by the SEC were rejected either because they do not assist in meeting the objectives of financial reporting in a cost-beneficial manner or because their usefulness would overlap that of the disclosures required by this Statement.

109. In the Exposure Draft, the Board specifically requested comment on the usefulness of requiring operational disclosures concerning acreage. Some respondents to the Invitation to Comment and the Exposure Draft expressed the view that disclosure of the quantity of undeveloped acreage would provide some indication of the enterprise's future exploration and

production efforts. However, most respondents to the Exposure Draft stated that disclosure of information about undeveloped acreage should not be required by this Statement principally because: (a) the quality of the acreage and its precise location are more important than its quantity, (b) that type of detailed information would be unduly voluminous and would be considered proprietary, and (c) information that describes general physical facilities is readily available outside of financial reports. Therefore, the Board did not require the disclosure of this type of operational information.

Interim Reporting

110. The Board and the majority of respondents to the Invitation to Comment and to the Exposure Draft believe that the disclosure requirements for oil and gas producing activities should apply to only complete sets of annual financial statements. Statement 19 specifically omits from its requirements for interim statements disclosure of information about reserve quantities and costs incurred. That Statement indicates that "the Board reached that conclusion principally because problems in gathering data of that type on a timely basis become especially acute at interim reporting dates and, for some companies, the costs of that effort may be unduly burdensome" (paragraph 234). The Board believes that those reasons for not requiring information about reserve quantities and costs incurred to be disclosed in interim reports are still valid. For the same reasons, information about the results of operations and discounted future net cash flows also should not be required in interim reports.

111. The Board rescinded the requirement in Statement 19 to report information about capitalized costs for oil and gas producing activities in interim financial statements or reports because that information is not essential for an understanding of the performance and financial position of the enterprise. That rescission is consistent with the provisions of FASB Statement No. 18, *Financial Reporting for Segments of a Business Enterprise—Interim Financial Statements.*

112. However, if interim financial statements or reports are presented, this Statement requires disclosure of information about a major discovery or other event that causes a significant change from the information reported in the most recent financial statements. That approach is consistent with Statement 19, paragraph 49, and APB Opinion No. 28, *Interim Financial Reporting,* paragraph 32, both of which seek commentary relating to the effects of significant events in interim financial statements or reports.

Applicability

113. If information about an enterprise's oil and gas producing activities meets the objectives of financial reporting and possesses the necessary degree of relevance and reliability, the Board believes that the only justification for excluding a particular enterprise (or group of enterprises) from the disclosure requirements would be that the costs of providing that information exceed the benefits. Respondents to the Invitation to Comment and to the Exposure Draft raised that

argument concerning the application of this Statement's requirements to enterprises that are not publicly traded and to publicly traded enterprises that do not have significant oil and gas producing activities. Furthermore, responses to the Invitation to Comment and to the Exposure Draft and testimony received at the public hearing specified the following reasons for omitting enterprises that are not publicly traded from specialized disclosure requirements:

a. The users of financial statements of enterprises that are not publicly traded are generally its owners and creditors. Those users usually are knowledgeable about the individual enterprise and its industry and frequently are directly involved in the management of the enterprise or have the ability to demand and obtain the information they need (for example, creditors).
b. In assessing the creditworthiness of enterprises that are not publicly traded, lending institutions generally require that their own staffs prepare estimates of reserve quantities and information about estimated future net cash flows from the petroleum engineer's report. Therefore, to require enterprises that are not publicly traded to report that information cannot be cost justified since those lending institutions would not be expected to use the information.

114. As previously indicated, the informational needs of the users of financial reports are the same for enterprises that are publicly traded and enterprises that are not publicly traded. However, creditors of and investors in enterprises that are not publicly traded, if they do not already have the information they require, usually are able to obtain it. Therefore, a Board requirement to report specialized information about oil and gas producing activities would provide little additional benefit to the users of those financial reports. The Board acknowledges that there are instances in which certain investors in closely held businesses may not have the ability to get the information necessary for decision making. However, comments received in the course of this project do not indicate that this is a widespread problem. The Board may need to reassess a possible requirement for enterprises that are not publicly traded to provide the information after completion of the Board's project on financial reporting by private and small public companies.

Location of Information within Financial Reports

115. The requirement to report specialized information about oil and gas producing activities and the issue of where that information should be reported were considered by the Board in 1979 as part of its consideration of Statement 25 requirements. Since that time, the Board has issued an Exposure Draft on reporting income, which offers some guidance on the placement of information within financial reports.

116. That Exposure Draft indicates that information with a different perspective from that reported in the body of the financial statements (for example, other than historical cost based information) can be reported as supplementary information. Presenting information about proved reserve quantities and estimated discounted future net cash flows as supplementary

disclosures would be consistent with that suggestion. In addition, cost-benefit considerations (as well as reliability considerations) indicate that information about the reserve quantities, estimated discounted future net cash flows, and results of operations should be supplementary because the placement of information outside the financial statements may result in lower auditing costs.

117. Also, that Exposure Draft indicates that detailed information or information useful for specialized analysis of financial reports can appropriately be considered supplementary. That supports the inclusion of the whole disclosure package for oil and gas producing activities—except for the disclosure of the enterprise's accounting method—as supplementary information. Reporting specialized information on oil and gas producing activities in a single location within a financial report is a desired objective of this Statement so as to make the relationship among the different types of information easier to analyze.

118. Since the industry does not use a uniform accounting method for costs incurred in oil and gas producing activities, this Statement retains the requirements of Statement 25 to disclose the accounting method within the financial statements.

Current Cost Information

119. Most comments received in response to the Exposure Draft's specific question concerning current cost for oil and gas producing activities addressed the decision usefulness of that information. The principal reason given by respondents who do not consider current cost information useful for oil and gas mineral interests is that it is not representationally faithful. That is, the amount does not represent the cost of replacing the enterprise's mineral interests. Respondents who supported disclosure of current cost information for oil and gas producing activities generally view it as a mechanical necessity to report current cost information in their consolidated operations. In addition, some supporters of current cost information for oil and gas producing activities believe that the information is useful since it provides information about part of the change in current cost—the part attributed to price changes—even though the uncertainty concerning future exploration and development defies measurement.

120. Respondents to the Invitation to Comment and to the Exposure Draft indicated that current cost measurements of oil and gas interests presented in annual reports for 1980 and 1981 usually reflected an indexed cost, in many cases the result of applying a general price index to past costs incurred to find oil and gas reserves, not a current finding cost of the same quantity and quality of mineral interests. Therefore, the Board has modified the requirements of Statement 39 to permit enterprises to use historical cost/constant dollar measures for oil and gas mineral resource assets in presenting supplementary information on a current cost basis.

121. The effect of the modification is to require enterprises to present information on a current cost basis only if the enterprise has significant holdings of inventory and property, plant, and equipment apart from its oil and gas mineral resource assets or certain other specialized assets.

However, the modifications allow enterprises to continue experimenting with developing current cost information for oil and gas mineral interests, and also allow the use of the present value of future cash flows associated with those mineral interests for enterprises that would expect to replace their oil and gas mineral interests by purchase.

Footnotes

FAS69, Footnote 1--Statement 19 defines oil and gas producing activities as "those activities [that] involve the acquisition of mineral interests in properties, exploration (including prospecting), development, and production of crude oil, including condensate and natural gas liquids, and natural gas . . ." (par. 1).

FAS69, Footnote 2--For purposes of this Statement, a publicly traded enterprise is a business enterprise (a) whose securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally) or (b) whose financial statements are filed with a regulatory agency in preparation for the sale of any class of securities in a domestic market.

FAS69, Footnote 3--FASB Statement No. 24, *Reporting Segment Information in Financial Statements That Are Presented in Another Enterprise's Financial Report,* refers to a complete set of financial statements as "a set of financial statements (including necessary footnotes) that present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles" (footnote 2).

FAS69, Footnote 4--FASB Statement No. 14, Financial Reporting for Segments of a Business Enterprise, defines an industry segment as "a component of an enterprise engaged in providing a product or service or a group of related products and services primarily to unaffiliated customers (i.e., customers outside the enterprise) for a profit" (par. 10).

FAS69, Footnote 5--If significant, the reserve quantity information shall be disclosed separately for natural gas liquids.

FAS69, Footnote 6--As defined in the paragraphs cited, exploration and development costs include depreciation of support equipment and facilities used in those activities and do not include the expenditures to acquire support equipment and facilities.

FAS69, Footnote 7--If oil and gas producing activities represent substantially all of the business activities of the reporting enterprise and those oil and gas activities are located substantially in a single geographic area, the information required by paragraphs 24-29 of this Statement need not be disclosed if that information is provided elsewhere in the financial statements. If oil and gas producing activities constitute a business segment, as defined by Statement 14, paragraph 10(a), and the business segment activities are located substantially in a single geographic area, the results of operations information required by paragraphs 24-29 of this Statement may be included with segment information disclosed elsewhere in the financial report.

FAS69, Footnote 8--Generally, only enterprises utilizing the successful efforts accounting method will have exploration expenses to disclose, since enterprises utilizing the full cost accounting method generally capitalize all exploration costs when incurred and subsequently reflect those costs in the determination of earnings through depreciation, depletion, and amortization, and valuation provisions.

FAS69, Footnote 9--The disposition of interest costs that have been capitalized as part of the cost of acquiring qualifying assets used in oil and gas producing activities shall be the same as that of other components of those assets' costs.

FAS69, Footnote 10--FASB Statements No. 40, *Financial Reporting and Changing Prices: Specialized Assets--Timberlands and Growing Timber,* No. 41, *Financial Reporting and Changing Prices: Specialized Assets--Income-Producing Real Estate,* and No. 46, *Financial Reporting and Changing Prices: Motion Picture Films.*

FAS69, Appendix B, Footnote 11--In April 1982, the SEC codified the relevant ASRs concerning accounting and auditing matters in Financial Reporting Release No. 1, *Codification of Financial Reporting Policies*.

FAS69, Appendix C, Footnote 12--A survey of 190 oil and gas financial analysts (conducted by Edward B. Deakin and James W. Deitrick of the University of Texas at Austin) shows that 90 percent supported disclosure of reserve values. Approximately 80 percent of those supporters indicated that the disclosures should be based on specified, uniform pricing and discounting assumptions. A survey of members of the Society of Petroleum Evaluation Engineers (conducted by B. P. Huddleston & Co., Inc.) indicated that over 70 percent of the 102 respondents believe that the "present value" of proved oil and gas reserves should be reported by publicly traded companies, based on current price information. Approximately 58 percent of those who responded support the use of a standard 10-percent discount rate in that calculation.